IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. 13

THE UNITED STATES, *Petitioner,*

v.

BELL AIRCRAFT CORPORATION, *Respondent*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENT

OPINION BELOW

The opinion of the Court of Claims (R. 101-35) is reported at 120 Ct. Cl. 398.

JURISDICTION

The judgment of the Court of Claims was entered on October 2, 1951. (R. 135) On December 29. 1951, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including January 30, 1952. (R. 136) The petition, filed on that date, was granted on March 31, 1952. (R. 139) The jurisdiction of this Court is invoked under 28 U.S.C. § 1255(1) (1946).

REGULATION AND CONTRACT PROVISIONS INVOLVED

The pertinent provisions of the regulations and contracts involved in this case are set forth in Appendices A and B, *infra* at pp. 73-88.

STATEMENT OF THE CASE

Bell Aircraft Corporation, the respondent, was the designer and builder of the P-39 fighter airplane of World War II fame—the Airacobra. The issue in this case is respondent's right to reimbursement from the petitioner for some $2,286,000 of costs incurred in connection with development and production of that plane. Resolution of that issue requires some understanding of the technical and procurement problems involved in United States military aviation before and during World War II, and the manner in which they were solved.

The events with which the controversy is concerned date back almost to the formation of respondent with three employees in 1935. (Tr. 125-26)[1] Within a year thereafter, respondent undertook to solve some of the peskiest problems of military aviation of that day through development of a new type of fighter airplane with adequate nose room and pilot vision, with the fire power of a true cannon and with efficient use of the important new Allison liquid-cooled engine. (R. 67-69, 95-98)[2]

Development of a new type craft was a risky and costly business. The most perfect calculation and design going into the drawings gave no reliable clue as to costs of production and no assurance of successful per-

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[1] As has the petitioner in its brief, we shall occasionally cite portions of the certified record not printed by the petitioner.

[2] The respondent's success in securing a craft with a long drive shaft and adequate nose room, and in solving certain shimmy problems with respect to the guns, led directly to the development of the revolutionary tri-cycle landing gear in the Airacobra. (R. 96, Tr. 49-51)

formance.[3] Hence, typically, the military first would order construction of hand-made, purely experimental planes. If all went well, the military would then order construction of a limited number of test craft of that type, still experimental and intended to provide the means for critical and exhaustive testing. If all then finally went well, the military would order the plane into production. At that point the aircraft company would outfit assembly lines and tool up for quantity manufacture. For this purpose so-called "production tools" were necessary, not ordinary machine tools but special structures and devices, usable only in the production of that type of craft, such as fixtures designed to hold portions of the aircraft exactly in place during fabrication. (R. 72)

In the system of letter-number designations used in military aviation, the prefix "X" designated the hand-made experimental planes. The prefix "Y" designated the test models. (R. 67) Upon regular production such prefixes were dropped.

Difficult as it was in the case of ordinary production to forecast aircraft costs, it was quite out of the question to forecast the costs of constructing the experimental craft;[4] nor would the military have any way

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[3] The impracticability of letting contracts on the basis of drawings alone has always been a complicating factor in aviation procurement. See Statement of Maj. Gen. E. M. Powers, Assistant Chief of Air Staff, *Hearings Before Subcommittee No. 6 of the House Committee on Armed Services on H. R. 1366*, 80th Cong., 1st Sess. 536 (1947); 1 ASF, Purchasing Policies and Practices, Official History of Purchases Division 22. This undated mimeographed manuscript is on file with the Historical Division, Department of the Army.

[4] H. R. Rep. No. 1634, Part 1, 77th Cong., 2d Sess. 233 *et seq.* (1942); Major Davidson Sommers, *Cost-Plus-Fixed-Fee Contracts*, 2, 13 (1944) (lecture presented at AAF Contracting Officers School, Wright Field, Dayton, Ohio, on file at the Army Library).

of appraising the value to it of such construction. Hence, in aircraft manufacture, a fixed price contract let for experimental production was simply a device whereby the military would defray a portion of the cost of the experiment. The excess of the manufacturer's costs over the military's payment would constitute what cost accountants denominate "experimental and development" or "e and d" costs, to be amortized over the production, if any, of the aircraft to which the experimental and developmental work was related.[5]

Upon reaching the production stage, the job of contracting took on a different character. Especially in the days when France was crumbling and England was tottering, it was impossible for either the military or the manufacturer to make predictions with certainty. A contract for a limited number of planes would be let; it would *probably* be followed by others; but obviously no one could tell how many others or when or in what quantities.[6] Furthermore, especially where the type

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[5] See General Arnold, *Hearings before Subcommittee of the House Committee on Appropriations on the Military Establishment Appropriation Bill for 1940*, 76th Cong., 1st Sess. 315 (1939).

[6] Lilley, Hunt, Butters, Gilmore, Lawler, Problems of Accelerating Aircraft Production During World War II 15, 22-30 (1946); John Perry Miller, Pricing of Military Procurements 20 (1949); John W. Fesler, Industrial Mobilization for War: History of the War Production Board and Predecessor Agencies 40, 47-50, 55-56, 121, 126 (1947); Joseph Carlyle Sitterson, Aircraft Production Policies Under the National Defense Advisory Commission and Office of Production Management, May 1940 to December 1941, 1-42, 50-60 (1946); Charles M. Wiltse, Aircraft Production Under the War Production Board and Predecessor Agencies, May 1940 to April 1944 1-13 (1944) (unpublished manuscript available at the National Archives).

was new, the problem of forecasting production costs was almost as much a problem of guessing—and very rough guessing—as in the case of the costs of the experimental planes. So, with scant cost data, and dealing with the fixed price type of contract, the manufacturer and the military would simply have to negotiate, as quickly as possible, some kind of price with the hope that it would be fair.

The government was afforded a considerable measure of protection by the provisions of the Vinson-Trammell Act, 48 STAT. 505 (1934), as amended, 34 U.S.C. § 496 (1946), which was made applicable to aircraft contracts in 1939. 53 STAT. 560 (1939), 10 U.S.C. § 311 (1946). This Act required that the contractor pay back to the government any profits made by it which exceeded a stated percentage. Although the Vinson-Trammell Act was suspended with respect to army aircraft by the excess profits tax law in late 1940, 54 STAT. 1003 (1940), 34 U.S.C. § 496a (1946), Congress adopted another form of profit limitation in the Renegotiation Act of 1942. 56 STAT. 245 (1942), as amended, 50 U.S.C. App. § 1191 (1946). This Act gave the Secretary of War (in the case of War Department contracts), through his designated agencies, the power to review a manufacturer's profits under a contract and, when they were deemed too high, to reduce the contract price or fee and to require refunds to the government.

In 1940, as the tempo of war quickened, Congress authorized procurement of army aircraft by cost-plus-fixed-fee contracts, hereinafter referred to as CPFF contracts. 54 STAT. 712 (1940), 50 U.S.C. App. § 1171 (1946).[7] This form of contract was designed to avoid

[7] In addition, this statute prohibited use of the cost-plus-percentage-of-cost system of contracting.

both the evils inherent in a cost-plus-a-percentage-of-cost system of contracting and the obvious awkwardness of the fixed price contract, especially where cost forecasting was virtually impossible and there was no time to engage in refined cost analysis.[8]

With the CPFF type of contract the manufacturer made a very generalized cost estimate.[9] The fixed fee

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[8] James V. Forrestal, *Hearings Before a Subcommittee of the Senate Committee on Military Affairs on S. J. Res. 80*, 78th Cong., 2d Sess. 656, 707 (1944); Donald M. Nelson, *id.* at 608-09; Robert P. Patterson, *id.* at 666-70; ANDREW JOHN KRESS, CONTRACT PRICING—PRINCIPAL DEVELOPMENTS, STUDY OF EXPERIENCE IN INDUSTRIAL MOBILIZATION IN WORLD WAR II 27 (1946); 1 ASF, PURCHASING POLICIES AND PRACTICES 231-33; JOHN PERRY MILLER, PRICING OF MILITARY PROCUREMENTS 93, 128 (1949); THOMAS BLANCHARD WORSLEY, WARTIME ECONOMIC STABILIZATION AND THE EFFICIENCY OF GOVERNMENT PROCUREMENT 52, 236, 238-39 (1948); Welch, *Types of Defense Contracts*, 12 FED. B. J. 233, 235 (1952).

[9] Admiral Moreell characterized the process of making cost estimates as a "stab in the dark," *Hearing Before the Senate Committee on Naval Affairs Relative to Cost-Plus-Fixed-Fee Contracts*, 77th Cong., 1st Sess. 4 (1941), and subsequently pointed out at page 14 that actual costs varied considerably from original estimates. E. W. Bell, Chief of the Audit Division of the GAO, pointed out that manufacturers' cost estimates were "in some cases . . . very high and in some cases low, and in some cases . . . a mere guess." *Hearings before a Subcommittee of the Senate Committee on Military Affairs on S. J. Res. 80*, 78th Cong., 2d Sess. 633 (1944). In a lecture on *Flexible Pricing in Fixed Price Contracts* presented at the AAF Contracting Officers School, Wright Field, Dayton, Ohio, in 1944 (available at the Army Library), Major Lloyd W. Dinkelspiel pointed out (pp. 1-6) that conditions prevalent in the aircraft industry during the war made it impossible for manufacturers to make cost estimates that were more exact than guesses. See also ANDREW JOHN KRESS, CONTRACT PRICING—PRINCIPAL DEVELOPMENTS, STUDY OF EXPERIENCE IN INDUSTRIAL MOBILIZATION IN WORLD WAR II, 93, 95

was then determined as a percentage of the estimated cost, and it remained so fixed, subject to the Renegotiation Act, regardless of what the actual costs turned out to be. The contracts also provided, without any reference to the cost estimates, that the government would reimburse the manufacturer for his actual costs. Instead of spelling out cost standards in the contract, it was provided that the costs would be determined by the War Department's Contracting Officer in accordance with some previously formulated cost code, specified by reference in the contract; one of the codes most frequently adopted was Section 26.9 of Treasury Decision 5000. (R. 78)

T.D. 5000, 1940-2 CUM. BULL. 397, was adopted in August 1940 pursuant to the Vinson-Trammell Act, as amended, as the standard to be followed by the War and Navy Departments in determining costs under aviation and ship building contracts. In substance, it provided that recognized cost accounting principles should be applied in cost ascertainment.

The CPFF contracts used by the Army Air Forces were prepared by its Legal Branch from standardized provisions prescribed or authorized by the War Department; deviation from standard clauses was permissible only in exceptional cases, and then only with the approval of the chief of the AAF supply service.[10]

(1946); JOHN PERRY MILLER, PRICING OF MILITARY PROCUREMENTS 132 (1949); THOMAS BLANCHARD WORSLEY, WARTIME ECONOMIC STABILIZATION AND THE EFFICIENCY OF GOVERNMENT PROCUREMENT 237-38 (1948); Fain and Watt, *War Procurement—A New Pattern in Contracts*, 44 COL. L. REV. 127, 143-44 (1944).

[10] General Swatland, *The Procurement Functions of the AAF, the ATSC and the Contracting Officer* 9 (1944) (lecture presented at AAF Contracting Officers School, Wright Field, Dayton, Ohio, on file at Army Library); Lt. Col. James G. Scarff,

After their authorization CPFF contracts gradually came into general use and use of the fixed price contract was sharply curtailed in aircraft procurement.[11]

The principal virtues of the CPFF form were these: A premium was not placed on increased costs, as in the discredited cost-plus form, since the fee was a fixed sum of money. Elaborate negotiations over cost problems were unnecessary since the matter was left to a Contracting Officer's determination in accordance with the accepted cost accounting principles detailed in standards such as T.D. 5000. And the fixing of a single over-all price to cover elements often unknown, and

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Negotiation and Administration of Contracts 16-17 (1944) (lecture presented at AAF Contracting Officers School, Wright Field, Dayton, Ohio, on file at Army Library). See also, War Department Procurement Regulations, 7 FED. REG. 6098, §§ 81.303(a), 81.304, 81.306 (Aug. 7, 1942); 7 FED. REG. 8082, §§ 81.303(a), 81.304, 81.306 (Oct. 13, 1942). The CPFF contracts in the present case disclose on their face that they were in the regular CPFF form. The contracts are Exhibits I, J. K and L to the Stipulation of Parties, Plaintiff's Exhibit 1 in the certified record. Government war contracts are said to be "merely non-consensual, in that the standard provisions and procedures are prescribed by the government for all who wish to deal with it." Fain and Watt, *War Procurement—A New Pattern in Contracts*, 44 COL. L. REV. 127, 207 (1944).

[11] In 1944 the AAF used the CPFF contract for 70 percent of all airframe purchases, 50 percent of all engine purchases, and 40 percent of all propeller purchases. Lt. Col. James G. Scarff, *Negotiation and Administration of Contracts* 7 (1944) (lecture presented at AAF Contracting Officers School, Wright Field, Dayton, Ohio, on file at the Army Library). Between June, 1940, and December, 1943, 55 percent of all AAF purchases of ten million dollars or more were by CPFF contract. *Hearings Before a Subcommittee of the Senate Committee on Military Affairs on S. J. Res. 80*, 78th Cong., 2d Sess. 618 (1944).

rarely known with any precision, was avoided.[12] While there was the risk that cost efficiencies might not be encouraged, since they would not increase profit, experience with the CPFF form apparently was reasonably satisfactory, for a similar form is still used in military procurement.[13]

Between mid-1936 and late 1938, the respondent entered into four fixed price contracts, three with the War Department and one with the Navy Department, for the development of a new type aircraft. Three of these contracts called for construction of single "X" aircraft; one called for construction of thirteen "Y" aircraft of one of the "X" models. (R. 67) From this experimental work there grew the Airacobra, designated P-39 and later P-63.

The fixed price for these aircraft of course fell far short of actual costs. (R. 69) The excess cost to the end of 1937 of the first of the "X" craft was charged off to current profit and loss by the respondent in 1937, and those costs drop out of this case. (R. 69) But as expenditures for experimental work by this small company increased in 1938, and with the prospect that the experimental work would prove successful, capitalization of these "e and d" costs was indicated; obviously they were being incurred in order to make future production possible. Such capitalization began as of the year end of 1938 and continued until the experimental work was completed; these costs were fully set up on the books at the year end 1940. (R. 69)

There is here no dispute as to the propriety or the amount of these costs. (R. 90) They were audited by the

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[12] THEODORE W. GRASKE, THE LAW OF GOVERNMENT DEFENSE CONTRACTS § 64 (1941).

[13] 62 STAT. 21 (1948), 41 U.S.C. §§ 151 *et seq.* (Supp. V 1952).

War Department and the respondent's figures were revised in accordance with this audit. (R. 73) Nor is there here any dispute that these costs were incurred in the development of designs, devices, and principles used in the planes ultimately put into production and are properly to be amortized as costs of such craft. (R. 95-99)

Beginning in 1939 and running into 1941 the respondent entered into a series of fixed price contracts with the War Department and with the British for the production of the P-39. There were seven such contracts, the last one being entered into with the War Department on June 5, 1941. (R. 71)

When production was undertaken, the respondent had to build "production tools" in a substantial amount. As we have seen, at that point it would be necessary to set up assembly lines, with a maze of devices especially designed for the P-39. (R. 72) The cost of these "production tools" was also deferred by the respondent in the same way as the "e and d" costs, to be amortized to future production; these costs were incurred month by month from April, 1939, through December, 1940, by which time they were fully set up on the books. (R. 73, 76; see Plaintiff's Exhibit 12 in the certified record.)

Like the "e and d" costs, there is here no dispute as to the amount or the propriety of these production tooling costs. (R. 90) They were audited by the War Department and the respondent's figures were revised accordingly. (R. 73) Nor is there here any dispute that the production tools were necessary for and were used in the production of the P-39 and that the original cost thereof is properly to be amortized instead of being currently expensed. (R. 99-100)

The total deferred "e and d" costs subject to amortization were $1,499,739.23; the total production tooling cost subject to amortization was $1,874,725.77. (R. 73)

The respondent's amortization was based on this plan: The total amount to be amortized as of the beginning of a calendar year would be divided by the sum of the P-39's on order at that time and the additional P-39's ordered in the course of the year; this would give, at the year end, the amount to be assigned to the cost of each aircraft. The respondent would then charge off, at the year's end, an amount arrived at by multiplying the number of P-39's actually delivered during the year by the amount thus assigned to the cost of each aircraft. (R. 73-74, 84) There has never been any dispute that this was a reasonable and proper basis for amortization. (R. 90)

The respondent's last fixed price type of contract was entered into in June, 1941. (R. 71) The next P-39 order was two months later, on August 14, 1941, and the contract therefor was in the then comparatively new CPFF form. Thereafter all of respondent's contracts were CPFF. (R. 77) There were five such. The second was entered into in September, 1941, the third in June, 1942, the fourth on September 28, 1943, and the fifth in January, 1944.[14]

Of course, under the amortization plan which the respondent had been following, the deferred costs would have been assigned in ordinary course to the

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[14] The fifth contract was for the P-63, a development from the P-39. This contract was later combined with the third contract which had been changed to call for P-63's. (R. 77) The lower Court treated the case as involving four CPFF contracts, in view of this combination; the War Department Board of Contract Appeals treated the case as involving five contracts. (R. 92)

craft produced under the CPFF contracts as well as to those produced under the fixed price contracts. But this did not happen. As found by the Court below:

> "According to the plan of amortization above referred to, a portion of the deferred experimental, development and production tooling costs would have been allocated to planes produced and delivered under these CPFF contracts. However, plaintiff's officials had been advised by Army Air Force officials that the deferred expenses in question might not be approved for reimbursement under CPFF contracts being negotiated. In order to avoid any question of allowable reimbursements, plaintiff changed its original plan of amortization by limiting the allocation of the deferred charges to its fixed-price production contracts only." (R. 74)

On this basis, the full amortization was accrued on the respondent's books by the year end of 1942, by which time all of the craft produced under the fixed price contracts had been delivered. (R. 76)

In 1942, however, the Bureau of Internal Revenue questioned the respondent's failure to amortize over all the P-39 aircraft. (R. 81) It insisted that this resulted in an understatement of taxable net income for 1941 by assigning to the P-39's delivered under fixed price contracts for that year a disproportionate amount of costs; the Bureau took the same position with respect to the respondent's income for the year 1942. (R. 82) Assignment of the costs to the P-39's produced under the CPFF contracts as well as those under the fixed price contracts would decrease the respondent's expenses for the years 1941 and 1942 and would mean an

additional normal and excess profits tax for those years amounting to $1,337,474.89. This additional amount was in fact assessed by the Bureau and paid by the respondent. (R. 82)

In the meantime the War Department had taken up the question of renegotiation with the respondent. (R. 82) Under the authority of the Secretary of War, pursuant to the Renegotiation Act, a Price Adjustment Section had the power to revise the price of a contract in the light of various statutory standards, including costs of performance, subject to review by a Price Adjustment Board in the War Department. The Chief of the Price Adjustment Section concerned with the respondent, Major Phagan, took exactly the same position as had the Bureau of Internal Revenue with respect to the amortization of the respondent's deferred costs over all P-39's. (R. 106) Accordingly the respondent, early in September, 1943, addressed a letter to Major Phagan agreeing to amortize the costs over all the aircraft instead of limiting amortization only to those produced under fixed price contracts, provided that the amounts "disallowed by you against fixed price contracts become items of reimbursable costs under" the CPFF contracts. (R. 82-84) On September 9, 1943, Major Phagan approved this course by the respondent. (R. 84)

The respondent restored to a deferred account on its books the sum of $2,286,819.55, representing the amount attributable to aircraft under CPFF contracts. (R. 84) There is no dispute in this case as to the propriety of this amount or the basis on which it was determined. (R. 90)

In August, 1943, the respondent had submitted to the War Department Contracting Officer administering its CPFF contracts cost vouchers providing for

reimbursement of the portion of this restored deferred account attributable to P-39's delivered under CPFF contracts through August, 1943.[15] This sum amounted to $1,299,856.02. (R. 85)

The War Department's Assistant Resident Auditor, assigned to the respondent, recommended that these vouchers not be paid. The Resident Auditor disagreed and recommended their approval. The Contracting Officer did approve them for reimbursement under the CPFF contracts, and the respondent was paid that sum by the War Department's Finance Officer in September, 1943. (R. 85)[15a]

Beginning in October, 1943, the respondent submitted additional vouchers for the remainder of the costs in the deferred account, applicable to aircraft delivered subsequent to August, 1943. These vouchers totaled $986,963.93. (R. 85) At about the time these vouchers began to arrive for audit the Resident Auditor and Contracting Officer were both replaced. The Assistant Resident Auditor again recommended against approval of vouchers covering these costs. (R. 86) The new Resident Auditor in December, 1943, requested advice from the Air Technical Service Command as to treatment of these costs, and the matter was held in abeyance for over a year until, after receiving

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[15] See Stipulation of Parties, Plaintiff's Exhibit 1, pp. 16-17, in the certified record.

[15a] The function of the Auditors was to assist and advise the Contracting Officer. ARMY TM 14-1000, ADMINISTRATIVE AUDIT PROCEDURES FOR COST-PLUS-A-FIXED-FEE SUPPLY CONTRACTS ¶¶ 5-6 (1944); Major Richard H. Demuth, *Administration of CPFF Contracts* 5-6 (1944) (lecture presented at AAF Contracting Officers School, Wright Field, Dayton, Ohio, on file at Army Library). The function of the Finance Officer was to make payments according to the Contracting Officer's order. ARMY REGS. 35-180 ¶3 (May 27, 1942).

such advice, the new Contracting Officer declined approval of the additional vouchers in January and March, 1945. *Infra*, at pp. 16-17. (R. 88-89)[16]

Meanwhile, in February, 1944, the Resident Auditor was again replaced. In April and May of 1944 the General Accounting Office submitted to this third Resident Auditor informal exceptions to the payment of $1,299,856.02 made to the respondent in September, 1943. (R. 86-87) In June, 1944, the Resident Auditor advised the General Accounting Office that deductions in that amount would be made from other vouchers of the respondent which were pending. (R. 87) The Contracting Officer, however, held up the vouchers from which deductions had been made by the Resident Auditor and took no action thereon until September, 1944. (R. 87) Prior to that time, on August 18, 1944, the Comptroller General had issued formal notices of exception and suspended the accounts of the War Department's Finance Officer who had made the payment to the respondent. (R. 87) At first there were two such exceptions which for some unexplained reason failed to include approximately $125,000 of the previous payment to the respondent. The Finance Officer immediately recouped the amounts in question by deducting these sums from vouchers otherwise due the respondent; the Comptroller General was notified thereof on August 25, 1944, four days after the excep-

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[16] Each of the two sets of vouchers covered both "e and d" costs and production tooling costs as follows (R. 85, 88):

	Total	"E and d" Costs	Production Tooling Costs
First set	$1,299,856.02	$ 407,871.26	$ 891,984.76
Second set	986,963.93	628,047.47	358,916.46
	$2,286,819.95	$1,035,918.73	$1,250,901.22

tions were received. (R. 87) Early in September the Contracting Officer transmitted to the Finance Officer for settlement groups of the respondent's vouchers, including those from which the Resident Auditor had made deductions in June. (R. 87) At the time of transmitting these vouchers the Contracting Officer restored the deductions, except for deduction of the $125,000 which had not been recouped by the Finance Officer and which had been overlooked in the Comptroller General's formal exceptions. (R. 87) At almost the same time the Finance Officer received from the Comptroller General a formal exception and suspension of his accounts with respect to this $125,000, and the Finance Officer immediately advised the Comptroller General that this sum had also been recouped by deduction from vouchers for sums otherwise due the respondent. (R. 88)

This recoupment at the instance of the Comptroller General was completed by September, 1944. (R. 88) It is important to note that the Contracting Officer took no action whatsoever with respect to this recoupment except for the sum of $125,000, and that *both his action and the action of the Finance Officer were merely in response to the Comptroller General's exceptions and did not purport to rule on any issue of cost reimbursability.*

In a memorandum dated November 13, 1944, the Chief of Procurement of the Air Technical Service Command finally responded to the December, 1943, request of the then Resident Auditor for advice as to treatment of these costs. (R. 88) On January 10, 1945, the second Contracting Officer transmitted to the respondent his decision on the vouchers for the sum of $986,963.93—the sum allocated to deliveries after August, 1943, to which we referred *supra* at p. 14. This

decision, in writing, opened with the following statement:

> "1. Forwarded herewith is a copy of a decision made by the Chief of the Procurement Division of the Air Technical Service Command on the reimbursement of amortization of development and experimental expense over CPFF contracts.
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> "2. This office incorporates the decision of the Chief of the Procurement Division as a finding of facts in denying reimbursement to the contractor for this expenditure, as requested on Audit Bureau Vouchers, as follows:"

There were then listed the series of vouchers which totaled $986,963.93. Attached to this decision was a copy of the memorandum of November 13, 1944, from the Chief of Procurement. This memorandum discussed the question of allocating the deferred costs to aircraft produced under CPFF contracts, without any distinction between the sums which had already been paid and the sums remaining on the pending vouchers, referred to the original informal exceptions of the General Accounting Office, briefly discussed the merits of the question, and concluded that, "It is therefore the opinion of this Headquarters" that the respondent is not entitled to reimbursement under its CPFF contracts "for any portion of the" deferred costs. (R. 88-89)

Under date of March 1, 1945, the same Contracting Officer sent to the respondent a further communication rescinding his January action and forwarding a new decision. (R. 89) The new decision listed the same unpaid vouchers as had the previous one (*i.e.*,

those totaling $986,963.93). It then proceeded to copy almost word for word the communication from the Chief of Procurement, a copy of which had been sent to the respondent in January, except that it omitted an introductory paragraph and substituted the words, "It is, therefore, the decision of the Contracting Officer", in the concluding sentence for the words, "It is therefore the opinion of this Headquarters". (R. 89)[17]

At this point the respondent made timely appeal to the War Department Board of Contract Appeals from the Contracting Officer's decision. (R. 89) Since the only action of the Contracting Officer was the disapproval of the vouchers for $986,963.93, the appeal was regarded as an appeal from that action. (R. 89) However, the Board discussed the issues in terms which would be equally applicable to the question of reimbursability of the $1,299,856.02, approved by the first Contracting Officer, had the Board believed it was acting upon that item. (R. 89-92)

The Board held that, "Under the circumstances here present, the Board is of the opinion that the costs are not reimbursable under the subject contracts." (R. 91-92)

Thereafter the respondent filed this suit in the Court below.

A disputes clause in each of the contracts provides that disputes concerning questions of fact shall be decided by the Contracting Officer, subject to appeal to the Secretary of War or his designated representa-

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[17] The Contracting Officer's decision of January 10, with attached memorandum from the Chief of Procurement, Plaintiff's Exhibit 25 in the certified record, and his communication and decision of March 1, 1945, Plaintiff's Exhibit 26 in the certified record, are printed in full in Appendix C.

tives.[17a] Three contracts authorized the Board of Contract Appeals to act as the designated representative of the Secretary of War; one contract provided only for appeal to the individual designated as representative of the Secretary of War, in this case the President of the Board. In both instances it was provided by a memorandum of the Secretary of War dated July 4, 1944, 10 CODE FED. REGS. § 803.318d (g) (Supp. 1944), that the designated representatives could consider questions of law.[18] There is no contention here that the Board's determinations of such questions have any finality; the petitioner's Petition for Certiorari states (at p. 10), "There is no doubt that the 'Disputes' provisions in Article 16 of each of the CPFF contracts made final and conclusive only those administrative determinations concerning questions of fact."

While the Court below made much more extensive findings than did the War Department Board, there is no significant difference between the findings except in the legal conclusions as to the interpretation of the contracts.

The contracts, as we have noted, do not define reimbursable costs save by incorporating, by reference, the provisions of T. D. 5000. The Board, recognizing that the developments resulting from the "e and d" expenditures were incorporated in all P-39's and that the production tooling was used in their manufacture under the CPFF contracts, held that the costs here in

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[17a] The disputes clauses in respondent's CPFF contracts were in two forms. Both are printed in Appendix B, pp. 84-88.

[18] The Board recognized in its opinion in this case that it was acting pursuant to such memorandum when it said, "Insofar as the questions presented by this appeal are questions of law they will be administratively determined pursuant to the memorandum of Secretary of War dated 4 July 1944." (R. 90)

question would be embraced by T. D. 5000 had it not been that:

(a) They were incurred prior to entering into these contracts and would have been incurred regardless of whether these contracts had been entered into. (R. 91)

(b) The respondent was charging these costs off to the fixed price contracts when it negotiated the CPFF contracts and at that time had no intention "of seeking reimbursement for such costs". (R. 91)

The Court, on the other hand, held that it was immaterial, under the terms of T.D. 5000, that what amounted to capital costs were incurred before any CPFF contracts were entered into or were occasioned by work which, at the time, was called for by fixed price contracts; that the experimental costs were incurred in expectation of production and the production under the CPFF contracts "represented a portion of the fulfillment of that expectation"; and that the production tooling was actually used not only for production under the fixed price contracts but also for production of exactly the same aircraft under the CPFF contracts. (R. 125-26) As to the respondent's intention "not to request reimbursement", the Court held that no such understanding was expressed in the contracts and that therefore the respondent's original intention did not create an immunity on the part of the petitioner. (R. 126-28)

The petitioner also argued to the lower Court that the respondent's appeal to the Board was directed only to the vouchers for $986,963.93 and that therefore the respondent had failed to exhaust its contractual

remedies with respect to the claim for $1,299,856.02 and so was foreclosed from recovering that sum. The Court rejected this argument. See *infra* p. 56 *et seq.*

While this matter was pending before the War Department Board the respondent's renegotiation agreement for the fiscal year 1942 was executed. It provided for a refund to the petitioner of $7,714,000, after tax credits. (R. 93) It also recognized that the respondent had adjusted its amortization of the deferred costs as required by the Bureau of Internal Revenue (R. 94) and provided that if the costs here in question are reimbursed under the CPFF contracts (as contemplated in the agreement of September, 1943, with the Chief of the Price Adjustment Section, *supra* at p. 13), there shall be a further refund to the petitioner of $667,000 with appropriate tax credit. (R. 94) Thus, if the lower Court is sustained, the respondent's cost reimbursement, renegotiation, and tax relationships with the petitioner will be on the same basis.

QUESTIONS PRESENTED

1. Under a standard CPFF contract, providing for cost reimbursement in accordance with the standards of T. D. 5000, should reimbursement be denied, for items coming within those standards, because the contractor did not originally expect to request reimbursement?

2. Is the question just stated a question of fact on which decision under the fact disputes clause of CPFF contracts is final, or is it a question of law open to judicial determination?

3. Is a contractor foreclosed from bringing suit on a portion of a claim because a Board of Contract Appeals regarded the contractor's appeal as not in-

volving such portion, despite the fact that the contractor did appeal from the only adverse decision of the Contracting Officer?

4. Is a decision of the Contracting Officer, made with knowledge of the relevant facts, approving reimbursement of a cost under the cost reimbursement provision of a standard CPFF contract open to reexamination either by successor Officers or in court?

Our discussion of the questions will be in the order stated above; the discussion of the last two questions will be combined.

SUMMARY OF ARGUMENT

I

The CPFF contracts in this suit provide that allowable costs will be determined by the Contracting Officer in accordance with T.D. 5000. The experimental work, allocated costs of which are involved in this case, developed the aircraft produced under those contracts. And the production tooling, allocated costs of which are also involved, was necessary for and was used in such production. T.D. 5000, as interpreted both by the War Department Board and by the lower Court, provides that such costs are allowable.

The Board held, however, that in this case such costs are not to be reimbursed because the respondent, when it negotiated the contracts, did not expect to seek reimbursement and consequently did not amortize such costs, on its books, over the production under such contracts during the first two years of such production. The lower Court held that the contract obligation is to be determined by the contracts as written, and not by some previous unilateral expectation or intent of one of the parties. The Court was correct.

CPFF contracts, framed by the petitioner itself, clearly provide that costs defined in T.D. 5000 shall be reimbursed. Even had there been an understanding between the parties that the costs in question would not be reimbursed, that understanding could not be enforced unless expressed in the written contracts; and here the findings show that there was not even such an understanding.

The petitioner's argument that T.D. 5000 merely defines the costs which *may* be approved by the Contracting Officer if he deems the "facts and circumstances" to warrant approval cannot be accepted. Such an argument would make of the contracts nothing but the definition of a *privilege* on the part of the petitioner to pay the respondent. But the contracts expressly state an *obligation* to pay.

II

The contracts provide that disputes concerning questions of fact shall be finally decided by a specified process within the War Department. The petitioner argues that the decision of the War Department Board was final under that provision.

The petitioner is incorrect in its statement that the question presented is whether the costs here involved were necessary or incident to the performance of the contracts. The only question is whether costs defined in T.D. 5000 are not to be reimbursed solely because the respondent did not at first expect to request reimbursement. The answer to this question turns wholly upon interpretation of the contracts. That is a matter of law open to judicial determination and not concluded by Departmental process. Fact disputes clauses such as those included in these contracts have

always been regarded as leaving to the courts the final decision of questions of contract interpretation. This view should not now be overturned.

III

A first set of vouchers, covering part of the costs involved here, was approved by the Contracting Officer and payment thereon was made to the respondent by the petitioner. Thereafter this payment was recouped at the instance of the Comptroller General, a stranger to the contracts, who filed exceptions and suspended the accounts of the Finance Officer who had made the payment. Still later a new Contracting Officer decided that a second set of vouchers, covering the remainder of the costs involved here, should be disapproved. This decision referred generally to the whole claim of the respondent, but the only matter pending before such Officer was the second set of vouchers and the only action taken by him, therefore, was disapproval of that set of vouchers. This decision was appealed in accordance with the Departmental process provided for in the contracts; on appeal the question was treated as involving only the second set of vouchers, although the findings and decision on appeal would have been equally applicable to the first set of vouchers if they had been deemed to be involved in the appeal. The petitioner now urges that contractual remedies were not exhausted before this suit was filed, with respect to the claim based on the first set of vouchers, because the appeal dealt only with the second set of vouchers; at the same time the petitioner insists that the second Contracting Officer's decision actually dealt with the whole claim.

This technical defense was unanimously rejected by the lower Court and properly so. It is enough to say

that the appeal was from the decision of the second Contracting Officer, whatever that decision was.

Furthermore, the contracts provide that the petitioner will currently reimburse the respondent for costs approved by the Contracting Officer. The first Contracting Officer did approve the first set of vouchers. There is no provision for redetermination of such an approval by a successor Contracting Officer, and it is contrary to the contractual scheme to read such a provision into the contracts. Nor can the petitioner repudiate the decision of the first Contracting Officer when suit is brought to recover on the cost vouchers approved by him. The contracts, written by the petitioner itself, vest in the petitioner's own Officer the power to determine, and such determination must have been intended to bind the petitioner. Hence the respondent was not called upon to appeal an adverse decision of a successor Officer upon vouchers previously approved by his predecessor, even if that decision purported to deal with such vouchers. The respondent is entitled to payment of the first set of vouchers merely upon proof of the first Officer's approval thereof, at least in the absence of fraud or misapprehension of the facts on the part of the first Officer when he took his action.

Alternatively, the proper interpretation of the contracts is that the decision of its own Officer will bind the petitioner on questions of fact, so that if the petitioner is correct in its argument that a question of fact is involved here the decision of the first Contracting Officer on the first set of vouchers is conclusive.

It will be recognized, of course, that if the question here is one of law, as we argue in our point II, the defense of failure to exhaust contractual remedies is not applicable, for the contracts do not purport to provide a process for the determination of such a question.

ARGUMENT

I

The Charges for Experimental and Development and Production Tooling Costs Made to the CPFF Contracts were Reimbursable Costs Under the Provisions of those Contracts.

Petitioner's argument as to the reimbursability of the costs here involved, and as to whether reimbursability is a question of fact or law, is based throughout on an inaccurate statement of what the issue really is. The issue is not, as petitioner asserts in its argument, whether the costs were "incurred as a necessary incident to the performance of the CPFF contracts." (Brief, p. 18) The question is whether costs otherwise admittedly covered by the cost reimbursement provisions of the contracts must nevertheless be denied reimbursement because at the time the contracts were negotiated respondent did not expect to seek reimbursement. When the question is so stated, and the provisions of the contracts are analyzed, it becomes apparent that the lower Court correctly interpreted the CPFF contracts to require reimbursement, and that its decision was one of a question of law open to its determination.

A. THE EXPERIMENTAL AND DEVELOPMENT AND PRODUCTION TOOLING COSTS ARE ALLOWABLE COSTS UNDER T. D. 5000.

Each of the CPFF contracts provides in Article 3(b) that:

> ". . . allowable items of cost will be determined by the Contracting Officer in accordance with Regulations for determination of the cost of performing a Contract as promulgated . . . in Section 26.9 of . . . T.D. 5000 . . ." (R. 78)

Petitioner's brief does not analyze the provisions of T.D. 5000 or discuss the facts which led the War Department Board and the lower Court to conclude that the costs here in question were within its terms. Conceding that the costs are within T.D. 5000, petitioner argues that the issue still remains whether the costs were incurred as a necessary incident of performance of the contracts, and that certain facts show that they were not. Both the terms of T.D. 5000 and the findings below are of vital importance.

The provisions of T.D. 5000 with respect to cost reimbursement are printed in full in Appendix A, pp. 73-83. The provisions immediately relevant to this controversy are as follows:

> "(a) *General rule.*—The cost of performing a particular contract or subcontract shall be the sum of (1) the direct costs, including therein expenditures for materials, direct labor and direct expenses, incurred by the contracting party in performing the contract or subcontract; and (2) the proper proportion of any indirect costs . . . incident to and necessary for the performance of the contract or subcontract.
>
> * * * * *
>
> "(e) *Factory cost.* . . .
>
> "(5) *Indirect factory expenses.*—Items, usually termed 'factory overhead,' which are not directly chargeable to the factory cost of performing the contract or subcontract but which are properly incident to and necessary for the performance of the contract or subcontract and consist of the following:
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> * * * * *

> "(D) *Fixed charges and obsolescence.*—Recurring charges with respect to property used for manufacturing purposes of the contract or subcontract, such as . . . allowances for depreciation of such property, . . .
>
> "(d) *Other manufacturing cost.*—Other manufacturing cost . . . includes items of manufacturing costs which are not properly or satisfactorily chargeable to factory costs . . . but which upon a complete showing of all pertinent facts are properly to be included as a cost of performing the contract or subcontract, as for instance, . . . 'deferred' or 'unliquidated' experimental and development charges. For example, in case experimental and development costs have been properly deferred or capitalized and are amortized in accordance with a reasonably consistent plan, a proper portion of the current charge, determined by a ratable allocation which is reasonable in consideration of the pertinent facts, may be treated as a cost of performing the contract or subcontract. . . ."

In considering the reimbursability of these costs the War Department Board *made absolutely no finding that they were not incident to or necessary for the performance* of the CPFF contracts.

First the Board found that:

> "There is no dispute between the parties as to the amount of the costs or as to the propriety of the method of allocation used by [respondent]." (R. 90)

Then, as to the "e and d" costs, it found that:

> "The experimental and development costs are clearly within the category of indirect costs as defined by T.D. 5000 and are specifically covered by Section 26.9(d) of T.D. 5000—set out above." (R. 90)

As to the production tooling costs, the Board found that:

> "There is no specific reference in T.D. 5000 to the amortization of production tooling costs and appellant has not pointed out a specific provision of T.D. 5000 which it considers as providing for the allowance of such an item of cost. In the pamphlet issued by the War and Navy Departments entitled 'Explanation of Principles for Determination of Costs Under Government Contracts' (Par. 18), it is indicated that items such as royalties and the amortization of the initial cost of dies, patterns, and special tools can logically be classified as direct shop costs and be charged to contracts on an equitable basis of apportionment. Section 26.9(e)(5)(D) of T.D. 5000 set out above also provides that charges for depreciation of property used in the manufacturing process may be treated as an item of cost. It is clear from the record and evidence that the production tooling was used in the performance of CPFF contracts calling for the production of the P-39 type of airplane. It would seem, therefore, that items of this type are within the intent and meaning of T.D. 5000." (R. 90)

With respect to the production tooling the Board thus specifically found that it was used in performance of

the contracts and therefore that its cost was within the intent and meaning of T.D. 5000. The finding that experimental and development costs were covered by T.D. 5000 is plainly based on a recognition that the experimental work developed the Airacobra produced under the CPFF contracts.

The Court of Claims also made specific findings as to the use in performing the CPFF contracts of both the production tooling (R. 99-100) and the results of the experimental and development work (R. 95-99). As the Court said, "... had the experiments not been conducted and the charges not incurred, defendant [*i.e.*, petitioner] could not have secured any of the planes from plaintiff [*i.e.*, respondent]." (R. 130) There can be no doubt of the correctness of these findings.

The experimental work represented a brilliant pioneering development of distinctive features which made the Airacobra a unique and advanced plane of its day.

As to the production tooling, P-39's could not be produced without it. As a matter of fact when P-39 production ceased the tooling had to be scrapped and the petitioner was credited with its salvage value under the CPFF contracts. (R. 99, 124) And when the production under the CPFF contracts began there were devoted to it production tools which were the equivalent of new tools (R. 99)—for after their original construction, as tooling wore out or became obsolete while production under the fixed price contracts proceeded, the cost of replacing and reworking such tools had not been deferred but had been charged against current production (R. 73) so that the continued production under the CPFF contracts had the benefit of a set of

tools completely in repair and up to date. (R. 99, 124)[19]

If the production under the fixed price contracts and that under the CPFF contracts had been physically separated in point of time, with the former completed before the latter began, this would have been the situation: The respondent could have scrapped the production tools upon the completion of the fixed price contracts and pocketed the salvage value thereof. Then it could have built a new set of tools for the CPFF production and there would be no question whatever but that the entire cost thereof should be amortized over the CPFF contracts. Needless to say, the petitioner would have paid a large amount therefor. As it was, in this case before CPFF production began the respondent continuously maintained and replaced the tools, treating the cost of maintenance and replacement as current cost of fixed price production, though the maintained and replaced tools were later devoted to CPFF production; and the CPFF production got the full credit for the *entire* salvage value of the tools at the conclusion of the CPFF production. (R. 99) It is small wonder that the lower Court found that T.D. 5000 contemplated that CPFF production should be charged with a fair portion of the original cost of the tools.

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[19] As the lower Court found, ". . . when the work was started on the CPFF contracts, the value of the original tooling was substantially the same as its original cost" in view of its constant repair and replacement theretofore. (R. 124)

B. THE FACTS RELIED ON BY PETITIONER AS A BASIS FOR DENYING REIMBURSEMENT HAVE SIGNIFICANCE ONLY IN TERMS OF RESPONDENT'S ORIGINAL INTENTION OR EXPECTATION WITH RESPECT TO REIMBURSEMENT.

The War Department Board stated, however, that, while the costs were covered by T.D. 5000, it did not follow that such costs must be reimbursed in all cases and under all circumstances. (R. 90) It then found certain facts which it considered to be pertinent. (R. 91) These same facts are now relied on by the petitioner. Analysis discloses that these facts have significance only in terms of the original expectation, purpose or intention of respondent as to whether it would request reimbursement of these costs.

These facts fall into two general categories.

The first relates to the time of the expenditures: They were made prior to the CPFF contracts and would have been made whether or not there had been any CPFF contracts. Save as these facts enlighten the respondent's state of mind when the CPFF contracts were negotiated, they obviously can have no legal significance. Typically costs of this type are incurred in advance; and typically, where production is to occur over a period of time under a series of orders or contracts, all prospective orders will not be in hand when the costs are incurred. *Douglas Aircraft Co.* v. *United States*, 95 Ct. Cl. 140 (1941).

The Board's reference to the facts concerning the time when the costs were incurred was simply an introduction to the second category of facts relied on by it, namely facts showing that at the time the CPFF contracts were negotiated the respondent did not intend to request reimbursement of these costs under the CPFF contracts.

There is no dispute as to these facts. What happened is set forth by the lower Court:

> ". . . it has not been shown that defendant relied on plaintiff's intention not to request reimbursement and because of such reliance changed its position so as to work an estoppel. The record merely indicates that some agent of defendant had expressed the opinion to plaintiff, prior to the execution of the CPFF contracts, that experimental, development, and production tooling expenses would not be reimbursable, and that plaintiff accordingly decided not to request reimbursement. This understanding, if any, was not expressed in the contracts ultimately entered into, although it might easily have been done by expressly excluding such items in the contract." (R. 126-27)

The War Department Board's findings are fully in accord. Indeed, that Board found that:

> ". . . no specific consideration was given to the question of reimbursement [of these costs] in the negotiation of the subject contracts." (R. 91)

Thus there is not the remotest suggestion that the reimbursement provisions of the contract were in any way affected or that the petitioner was induced to change its position by the respondent's original expectation not to seek reimbursement of these costs. Neither findings nor evidence hints at anything of the sort. The petitioner makes no such contention, and it could not do so on this record. And all that the petitioner says in its brief about the respondent's bookkeeping, certain statements by the respondent's officials, and what was included in the cost estimates merely elaborates upon the fact that, prior to the time when the Bureau of Internal Revenue forced the issue, the respond-

ent had not expected to request reimbursement of these costs.

As far as the respondent's bookkeeping is concerned, the situation is clear cut. Prior to the time the CPFF contracts were entered into, the *fact* is that the costs were being amortized over fixed price contracts with the petitioner and the British. (R. 73-76) It could not have been otherwise, *for there was no other P-39 production.* As one after another fixed price contract was secured, the planes ordered thereunder would come into the amortization base. This is evident not only from the findings (R. 73-74) but also from the statements of the respondent's accountants, Price, Waterhouse & Co., in the respondent's Annual Reports (R. 74-76) to which the petitioner's brief refers with some emphasis. Consequently if the contract of August 14, 1941, had been another fixed price form of contract instead of being the first CPFF form of contract, the respondent's bookkeeping would have embraced in the amortization the planes produced under it just as it did those produced under the last fixed price contract entered into only two months previously. (R. 74, 76)

It makes no difference how this bookkeeping is described—whether it be described as amortization over *fixed price* P-39 contracts or as amortization over *any* P-39 contracts, the *fact* is that until August 14, 1941, there were no contracts except fixed price contracts and the respondent's bookkeeping amortized only over such contracts.

Of course the amortization plan being followed by the respondent, see *supra*, p. 11, required a determination of amortization at each year end. Consequently it was not until the end of 1941 that there was any occasion for distinguishing between different

P-39's in the recording of amortization on the books. At that time the CPFF contract production was not brought into the amortization base. But all that this means is that the respondent's intention at that time not to seek reimbursement was reflected in the books which its Comptroller was keeping. And our contention, agreed to by the lower Court, is that as a matter of law that fact is irrelevant, for books do not create or pay costs but merely record them, and if books are wrong in the reflection of costs the books can be changed. PATON, ADVANCED ACCOUNTING 269 (1947); HATFIELD, SANDERS, BURTON, ACCOUNTING PRINCIPLES AND PRACTICE 311-12 (1940). Books cannot change facts. *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 187 (1918); *E. P. Greenwood*, 34 B.T.A. 1209, 1214-15 (1936). *Cf. Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 643, n. 40 (1944). The cases are literally legion where costs are found to be different from their recording.[20] Except where there is some special statutory provision or some special consideration of policy, such as the strict rule of annual accounting periods for income tax purposes, accounting entries bind no one. *Norfolk & Western Ry.* v.

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[20] A taxpayer may be allowed to correct a tax return for an earlier year by taking depreciation on patents even though no depreciation was claimed thereon in the original return. Union Metal Mfg. Co., 1 B.T.A. 395 (1925). The SEC conditions the issuance and sale of securities on such retroactive accounting adjustments as the write-down of a property account. See, *e.g.*, Utah Power and Light Co., 14 S.E.C. 764, 781-82 (1943). Rate orders finding assets to have been overdepreciated have corrected such overdepreciation. See, *e.g.*, *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 596-98 (1944); *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U.S. 151, 165, 169-75 (1934).

United States, 287 U.S. 134, 141-42 (1932); *Commissioner* v. *Union Pacific R.R.*, 86 F. 2d 637, 639 (2d Cir. 1936); *New York Central R.R.* v. *Commissioner*, 79 F.2d 247 (2d Cir. 1935), *cert. denied*, 296 U.S. 653 (1935); *Bessemer Investment Co.* v. *Commissioner*, 31 F. 2d 248 (2d Cir. 1929); *Douglas Aircraft Co.* v. *United States*, 95 Ct. Cl. 140, 148 (1941); Hills, *Statement of Legal Concepts of Accounting*, 36 Iowa L. Rev. 198, 208-09, 225 (1951).[21]

The petitioner also refers to a statement made by one of the respondent's officials during the time between the letting of the first CPFF contracts and the respondent's decision to seek reimbursement. The statement is quoted by the petitioner (Brief, p. 8) but it is not identified. The petitioner neglects to explain that it is a mere intra-office memorandum of September 19, 1942, from the respondents Treasurer to its Comptroller, dealing with the argument which the respondent was then having with the Bureau of Internal

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[21] There is a suggestion in the War Department Board's opinion that respondent did not prove that the costs in question were not recovered under the fixed price contracts. (R. 91) This reflected a similar suggestion by the second Contracting Officer to the effect that profits under fixed price production were "more than enough" to recover these costs "and were so treated on the books" of the respondent. (R. 88) These suggestions point to an argument, made below, that the Government would be paying twice for these costs if the respondent prevails. Aside from the fact that the Government was not the sole fixed price customer, such a point is so clearly without merit that the petitioner does not pursue it here. The making of entries on books does not "recover" costs; still less does it pay them. Furthermore, this is not even a case where an asset, fully amortized *before* a particular production process began, is being revalued and charged off *anew* to that production. Nothing is proposed here except to charge to the CPFF contracts a proper portion of *those costs which had not yet been amortized when CPFF production began.*

Revenue and stating that the costs should be allowed as then recorded on the respondent's books because amortization thereof over the CPFF contracts would be permissible only if such costs had been "included in the original negotiations of such [CPFF] contract. No provision is made for that on any of our cost plus contracts in view of the position taken by the Government that prior to our entry into cost plus contracts we have received sufficient fixed price contracts to permit the amortization of deferred experimental expenses." (R. 82) Such an intra-office memorandum in September, 1942, obviously has nothing to do with the case. The respondent was arguing with the Bureau about a large deficiency assessment, and the statement by the respondent's Treasurer to its Comptroller during that argument certainly cannot define the petitioner's contractual obligation under contracts entered into both long before and long after that time. Furthermore, all that the memorandum reflects is a mistaken understanding in the mind of the Treasurer as to the law; he quite obviously had been led to believe by someone in the War Department that cost reimbursement under a CPFF contract hinged on whether the cost item was "included in the original negotiations." (R. 82) A layman might believe this; but as we shall see there is no basis for this mistaken conception.[22]

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[22] Petitioner also quotes in its brief (p. 9) two sentences from a statement of accounting policies by respondent's Comptroller in April, 1943. (R. 82) The petitioner has misconstrued the passage. Actually it says no more than that current CPFF experimental, development and production tooling expenses were charged *directly* to production, as distinguished from overhead. (Tr. 262-63) The point is immaterial, however, for it is evident that at that particular time the costs here in question had not been charged to CPFF production.

The petitioner and the War Department Board also cite the fact that the respondent did not include any allowance for these costs in the estimated cost of the CPFF contracts which it submitted to the War Department. (R. 91) The Board did not intimate that this fact was of any significance save as it may have some bearing on the respondent's original intention.

The fact is that the respondent made no such allowance in its cost estimates submitted to the War Department *either* for fixed price contracts (R. 73) *or* for the CPFF contracts. (R. 91) No one would suggest that the absence from the fixed price estimates of an allowance for these costs would mean that an appropriate portion thereof is not properly a cost of production thereunder. No more can it be suggested that their omission from estimates made in connection with the CPFF contracts means that an appropriate share thereof is not properly a cost of production thereunder.

C. RESPONDENT'S ORIGINAL INTENTION REGARDING REIMBURSEMENT OF COSTS IS IRRELEVANT.

We come now to the question of the legal significance of the respondent's original intention.

As we have seen, the respondent did not at first expect to seek reimbursement because it had been given the impression by War Department officials "that the deferred expenses in question might not be approved for reimbursement." (R. 74) CPFF contracts were then quite new, respondent had no experience with them (Tr. 212), and there were many unresolved questions concerning cost reimbursability. Indeed, there doubtless still are. This is not the first or the last time that a contractor, for any one of a dozen reasons, entered into a CPFF contract thinking that it would

not seek reimbursement of some particular cost. But this is the first time, as far as we know, that it has been suggested that such a thought should deprive a contractor of rights granted him by the contract—that the CPFF contract will not permit reimbursement unless the contractor has decided to seek reimbursement and asserts such an intention in the course of negotiations.

1. To overrule the lower court would be to disregard the underlying theory and the specific provisions of the CPFF contracts.

A consideration of the underlying theory of CPFF contracts and of the specific provisions of the contracts designed to carry out that theory makes it entirely clear that a contractor's intention with respect to seeking reimbursement of particular costs is expressly excluded from the circumstances made pertinent to the legal *right* to reimbursement. As indicated in our statement of the case, *supra,* pp. 5-9, despite its shortcomings the CPFF contract was and still is a necessary procurement device in a period when rapid expansion of facilities and prompt provision of war materials are essential, but where conditions are changing so rapidly and the materials to be produced are so complicated and subject to such continual variances that any detailed determination of costs in advance is impracticable. The whole purpose of the CPFF contract is to leave cost determinations to the application of the standards of T.D. 5000 *as performance proceeds.*

Cost estimates are submitted but their function under the CPFF contract is the determination of the fixed fee, based upon a percentage of estimated costs. Article 3(a) of the contracts (R. 77-78) provides for

a fixed fee based upon such a percentage of estimated cost and continues as follows:

> "This estimated cost and the fixed fee are subject to increases or decreases resulting from authorized changes as provided in Article 5 hereof. Provided, however, that there shall be no adjustment in the amount of the fixed-fee as provided herein, nor shall there be any claim for increased compensation, because of any errors and/or omissions made in computing the original estimated cost of the work or where the estimated cost varies from the actual cost."

Thus, the contracts expressly recognize the possibility that allowable costs will not be included in the cost estimates, either by reason of error or by reason of conscious omission, and they make provision for the consequences. There is to be no adjustment of fee by reason of such error or omission in the estimates, but the contracts do not provide, and clearly do not contemplate, that costs not included in the estimates shall for that reason cease to be allowable costs under the contracts.

Other provisions of the CPFF contracts not considered by the War Department Board clearly make irrelevant to the contractual obligations the contractor's intention with respect to seeking reimbursement. Each of the CPFF contracts contains a provision that if, prior to final settlement under the contract, T.D. 5000 shall have been amended so as to provide for additional allowable items of cost, "such additional items shall be considered allowable items hereunder." (R. 19)[23] In other words, if respondent in negotiating

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[23] Appendix B, *infra*, pp. 84-85.

the CPFF contracts had not intended to request reimbursement of these items because it had been *correctly* advised that T.D. 5000 did not provide for reimbursement and T.D. 5000 had been subsequently modified to provide reimbursement, then respondent would be entitled to allowance of its claim. Certainly no greater effect should be given to *erroneous* advice concerning T.D. 5000.

Each of the contracts also provides that any cost incurred by the contractor which would constitute an allowable cost under the reimbursement provisions of the contract shall be included in determining the amount payable

> "notwithstanding any provisions contained in the specifications or other documents incorporated in this Contract by reference, designating services to be performed or materials to be furnished by the Contractor at its expense or without cost to the Government." (R. 78. See Appendix B pp. 84-85, *infra.*)

In other words, if a written document incorporated in the contract had *expressly* provided that respondent should furnish production tooling or the results of its experimental and development work *without cost to the Government*, the proper charge for these items in accordance with T.D. 5000 *would still be reimbursable.*

The effect of this provision was considered by the War Department Board of Contract Appeals in *Douglas Aircraft Co.*, Nos. 1346 and 1376 (WDBCA 1946). The appellant had contracted with the Corps of Engineers to equip a modification center for the Army Air Forces in the Mojave Desert, California. In seeking a preference rating for materials to build a swimming pool, appellant stated that it pro-

posed to install the pool at its own expense. Later the engineering contract was modified to provide for payment for the pool but the item was disallowed by the Contracting Officer because the modification was subsequent to completion of the pool. Douglas then filed a claim for reimbursement under a CPFF contract which it had entered into with the Army Air Forces for operation of the center. This claim also was denied by the Contracting Officer. The appeal from the first decision was disallowed because not timely, but the cost was allowed under the Air Force operating contract despite the fact that Douglas had not contemplated seeking reimbursement of the cost under this contract and had made no claim for reimbursement until after denial of its claim under the engineering contract. The pertinent part of the opinion is as follows:

> "The first matter for consideration is the statement originally made by appellant's president that the swimming pool would be built at appellant's expense. Such statement was made prior to the execution of the Air Force contract and cannot in any sense be regarded as conclusive against a claim for reimbursement under that contract if the provisions thereto sanction such claim.
>
> "Where an expenditure is generally reimbursable under a cost-plus-a-fixed-fee contract it may be excluded from payment only in the event there is a specific contract provision of exclusion. See *Williston on Contracts* (*War Contract Claims*), Vol. 9, Sec. 46, p. 67. Certainly the statement in question had no element of a contract obligation and appellant was not bound to undertake at its expense the construction of a pool, or to complete

one of [sic] begun. Furthermore an integrated contract provision (such as T.D. 5000) would be conclusive against any preliminary understanding of the parties. See *Restatement, Contracts* (1932) Section 230. It is a well settled principle of law that any preliminary negotiations become merged in the written instrument and such instrument is presumed in law to express the final understanding of the parties. See *Simpson* v. *United States*, 172 U.S. 372, 379; Appeal of *McCloskey and Company*, BCA No. 559, 3 CCF 835.

"The most conclusive argument against any contention that the statement of appellant's president expressing willingness to construct the pool at appellant's expense precludes a claim for reimbursement is perhaps to be found in Article 3(b)(16)(d) of Air Force contract recognizing as reimbursable costs the following:

> '(d) Any cost incurred by the Contractor under the terms of this contract which would constitute an allowable item of cost under the provisions of paragraph (b) of this Article shall be included in determining the amount payable under this contract, notwithstanding any provisions contained in the specifications or other documents, incorporated in this contract by reference, designating services to be performed or materials to be furished by the Contractor at its expense or without cost to the Government.'

"Paragraph (b) above referred to, is the provision making T.D. 5000 determinative of allowable costs. If a cost made reimbursable by T.D.

> 5000 is to be paid notwithstanding that some other provision of the contract may have stated it was to be performed or furnished at the contractor's expense then *a fortiori* it should not be held that appellant is precluded from later relying on T.D. 5000 merely because prior to the contract it expressed willingness to bear the cost of constructing the pool. Certainly it would be illogical to give greater effect to a noncontractual expression than is accorded a definite contractual obligation."[24]

The purpose of incorporating a standard such as T.D. 5000 in the CPFF form of contract was to promote uniform cost ascertainment among different contractors.[25] The contracts were written by the petitioner; in fact they were prescribed forms. In treating respondent's intention as a pertinent fact affecting reimbursability of the costs in question, the War Department Board overlooked the underlying purpose and the specific provisions of the CPFF contracts.

It is important to observe that this case is not even one where there was an *understanding* between the parties not expressed in the written contract. Neither the War Department Board nor the lower Court has made a finding that the *petitioner or its agents* intended that the costs would not be claimed or reimbursed.

The most that happened is that at some time some War Department official told someone representing

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[24] This opinion is available at the Army Library.

[25] 1 ASF, PURCHASING POLICIES AND PRACTICES, OFFICIAL HISTORY OF PURCHASES DIVISION 268-71. To further assure uniformity, cost interpretations were issued and the Fiscal Division prepared and distributed a manual of uniform auditing procedures on CPFF contracts. *Id.* at 270-71.

the respondent that such costs "might not be approved for reimbursement under the CPFF contracts." (R. 74) Thus there is not the slightest warrant in the findings or the evidence for the petitioner's statement that "the parties [sic] understood, when the contracts were entered into" that the costs here in question "would not be claimed as reimbursable costs." (Brief, p. 3) The only *intention* found either by Board or Court is the unilateral intention of the respondent. (R. 91, 126)[26]

And, needless to say, the petitioner's statement that this intention existed "when the contracts were entered into" is quite careless—for, as already noted, *supra* pp. 11, 14—two of the CPFF contracts were entered into *after* the first set of vouchers had been submitted, approved by the Contracting Officer, and paid.

Thus the petitioner's case presents in extreme form the proposition that the unilateral intention of one party to a written contract, not reflected in the writing, and never expressed as irrevocable or as a promise either in a technical or in any other sense, shall be seized upon to define contractual obligation.

2. To overrule the lower court would be to disregard basic principles of contract law.

To overrule the lower Court would produce a strange and confusing situation. It is basic to contract law that the clear language of a written agreement is to be

[26] At page 7 of its brief the petitioner states that, "In the course of the negotiations it was understood *by both parties*" that respondent did not intend to charge any of these costs against CPFF production. Three record citations are given, no one of which gives any support for the conclusion that the petitioner knew of the respondent's expectation during the negotiations, much less had an *understanding* that there would be no charge.

interpreted only by reference to the words within the four corners of the contract. This is true even in extreme cases where the actual intent of both parties was entirely different from the meaning of the written words. And this rule has even greater force when the party who drafted the agreement is the party attempting to introduce contrary evidence of subjective intent. *E.g., Calderon* v. *Atlas Steamship Co.*, 170 U.S. 272, 281 (1898); *Moran* v. *Prather*, 23 Wall. 492 (U.S. 1874); *New York Sash & Door Co.* v. *National House & Farms Ass'n, Inc.*, 131 N.J.L. 466, 36 A.2d 891 (1944); 3 WILLISTON, CONTRACTS § 610 (Rev. Ed. 1938). The application of this rule is of vital importance to parties who have taken the pains to reduce their bargain to writing. It is the very purpose of a writing to avoid the misunderstandings so easily born of the vagaries of statements or hints or suggestions made in the course of negotiations, even assuming utmost good faith on both sides.

A keystone principle of contract law will be overthrown, in the law of government contracts, if the lower Court is reversed. For then, under the guise of "all the facts and circumstances"—or, as petitioner puts it, "pertinent facts"—rights will be defined, not by the written memorial, but by statements, actions, and other behavior in the course of negotiation —indeed the mere expectation of a party—even without the slightest evidence of detrimental reliance. No matter how petitioner attempts to argue this issue in its brief, the ultimate fact is that the War Department Board sought to create a new doctrine which would throw an established substantive rule of law out a door labeled "all the facts and circumstances." The lower Court properly refused thus to undermine long established principle.

There remains to say a word about the petitioner's "windfall" argument.

The petitioner states, quite correctly, that the change in amortization for tax purposes resulted in an increase in the respondent's net tax liability for the years 1941 through 1945 of only $32,000. (Brief, p. 9; see also p. 48) What is not quite clear from the petitioner's brief, however, is that this was fortuitous. As of the time the Bureau of Internal Revenue first acted, the respondent had to pay a tax deficiency of $1,337,474.89. (R. 60) Whether taxes for future years would be reduced by an amount largely offsetting this figure depended on whether the entire income earned by the respondent from all sources would suffice to absorb the increased amortization in future years and to reduce normal and excess profits taxes accordingly. A number of contingencies, ranging from a sudden ending of the war to a change in the military's procurement program, might well have left this respondent in a very different condition. It is hardly sound to make rules of law and contract interpretation depend upon "equities" disclosed by long-after-the-event circumstances.

The real "equity" of the case, of course, is that in the absence of countervailing considerations of policy the several branches of the petitioner should deal with a party on a consistent basis. Thus, in renegotiation —where the contracting agency itself takes the action —the government seeks to resolve cost questions in accordance with the determinations of the Bureau of Internal Revenue. 56 STAT. 983 (1942), as amended, 50 U.S.C. App. § 1191(c)(2)(1946). See OFFICE OF THE GENERAL COUNSEL, NAVY CONTRACT LAW 127 (1949). See also H.R. REP. No. 871, 78th Cong., 1st Sess. 36-37 (1943). That happened in this very case

where the Price Adjustment authorities took precisely the same position as did the Bureau with respect to amortization of these costs. (R. 106) There is not the slightest reason for the original contract obligations to be dealt with on a different basis; both law and accounting point to the correctness of the amortization insisted upon by the Bureau. The Price Adjustment Board, in order to give the respondent protection, did finally agree that its recovery of additional amounts in the renegotiation would be contingent upon reimbursement to the respondent of these costs under the CPFF contracts; that action simply underlines the practical necessity that the petitioner's branches act consistently.

If the lower Court is affirmed, respondent and petitioner will be in exactly the position they would have been in had some representative of petitioner not given an erroneous impression to the respondent as to reimbursable costs under T.D. 5000 which led respondent to cut off, on its books, the contracts over which these costs were to be amortized. That matter of bookkeeping did not affect by one cent what the respondent was paid under the fixed price contracts or affect the cost provisions of the CPFF contracts in any way whatever. The lower Court has put the parties exactly where they would stand according to the dictates of T.D. 5000. That is where the petitioner's own form of contract put them, and erroneous bookkeeping, prompted by an early doubt of how T.D. 5000 would be applied, should not be permitted to obscure the obligation framed by the petitioner itself.

To conclude: There is a rather vague suggestion at pp. 30-31 of the petitioner's brief that the CPFF contracts provide that if a cost is *permissible* under T.D. 5000 it *may* be reimbursed but does not *have* to be. We have not been able to follow this argument. Article

3(a) of the contracts provides that, "The Government *will* pay the Contractor . . . the cost . . . ." (R. 77) Article 3(b) provides that, " . . . allowable items of cost *will* be determined by the Contracting Officer in accordance with . . . T.D. 5000 . . . ." (R. 78) And Article 6(a) provides that, "The Government *will* currently reimburse the Contractor for such expenditures made in accordance with Article 3 . . . ." (R. 80) Either T.D. 5000 does or it does not make the costs here reimbursable. If it does not, the lower Court should be reversed. If it does, as we urge, then the respondent has a right to payment; the CPFF contracts certainly do more than merely to confer a privilege on the petitioner to make a payment!

Apparently, in last analysis, the petitioner's argument in this case is that under the contracts a Contracting Officer, in dealing with a T.D. 5000 cost, has discretion to pay or not to pay depending upon "the facts and circumstances." It is hardly to be assumed that any such blank check has been signed by CPFF contractors. The result of the argument to which the petitioner seems to be driven is that T.D. 5000 is no standard at all—save a standard of *exclusion*—and that any *included* cost reflects a *right* only when an unlimited discretion of a Contracting Officer condescends to make it such. Contracting Officers have great power under the contracts prescribed by the Government, as every government contractor knows, but this novel suggestion would create power without any limit whatsoever. Were this Court to adopt the suggestion, it would have translated the Disputes Clauses of government contracts into provisions which, though *professing* to give a contractor access to judicial determination of questions of law, would give complete finality to every decision of the contracting agency.

II

Whether the Experimental and Development Expenses and Production Tooling Costs Were Allowable Under the Provisions of the CPFF Contracts Presented a Question of Interpretation of the Contracts as to Which the Administrative Determination Under the Fact Disputes Clause Was Not Final and Binding.

Each of the CPFF contracts contains a provision that disputes "concerning questions of fact" shall be decided by the Contracting Officer, subject to administrative appeal, and that the decision on appeal shall be "final and conclusive." (R. 80-81) The petitioner agrees that if questions of law are presented the parties are not bound by the decision of the War Department Board. (Petition for Certiorari, pp. 10-11)

A. THIS CASE PRESENTS A STRAIGHTFORWARD QUESTION OF CONTRACT INTERPRETATION.

The petitioner argues that the dispute is "whether the deferred experimental, development and tooling costs were in fact incurred as a necessary incident to the performance of the CPFF contracts" and that, "It is settled that claims involving the ascertainment of cost pose inquiries of fact." (Brief, p. 18) It concludes therefrom that the decision of the War Department Board in this case is final and binding.

In the preceding section of this brief we have discussed the merits of the respondent's claim. Certain matters of fact, of course, are subsidiary to the controverted question involved in that claim—there never was a question of law, including a question of contract interpretation, that could be presented except in the light of some set of facts. Here the facts are: The

experimental work developed the planes produced under the CPFF contracts to exactly the same extent as those produced under the fixed price contracts (R. 95-98); the planes produced throughout were the same (R. 70-71, 77)—the difference between fixed price production and the CPFF production being no more than a difference in the form of contract, not a difference in work done or in the product; the production tools were necessary for and actually devoted to this production (R. 99); the respondent at first did not expect to request reimbursement and kept its books accordingly; then it changed its mind. (R. 82-84)

The only question, then, is whether costs which admittedly are otherwise reimbursable under T.D. 5000 lose that character because the respondent originally did not intend to request reimbursement. The respondent asserts that its intention and related facts are quite irrelevant to the petitioner's contractual obligation to pay set forth in the written agreements; the lower Court agreed with this interpretation of the contracts.

It is submitted that the question, therefore, is not one of a factual inquiry into whether these costs were "incident to the performance of the CPFF contracts" as the petitioner asserts. The War Department Board made no finding that they were not incident to such performance.[27] The question, rather, is a straightfor-

[27] The petitioner appears to intimate that the Board found that there was no "necessary proximate relationship" between the claimed costs and performance of the CPFF contracts. (Brief, p. 29.) Nothing could be more proximate than the actual use of the tools in the production and the actual development from the experimental work of the precise plane produced. In terms of proximation, the relationship to the CPFF P-39 was exactly the same as to the fixed price P-39. The dispute does not concern these matters of physical, technical relationships at all. It is wholly

ward issue of contract interpretation. The lower Court's decision accords with settled legal principles; the Board's view of the matter (and it plainly inferred that a question of law was involved, see *supra* p. 19, n. 18) would import important new principles applicable to the definition of rights and obligations under government contracts.

B. IT IS WELL SETTLED THAT QUESTIONS OF CONTRACT INTERPRETATION ARE NOT DISPUTES CONCERNING QUESTIONS OF FACT WITHIN THE MEANING OF THE FACT DISPUTES CLAUSE.

It need hardly be argued at length that a question of contract interpretation was open to the lower Court. Maddren, *Administrative and Judicial Machinery,* 10 LAW & CONTEMP. PROB. 659, 674 (1944).

That Court early adopted such a view of its powers in determining the finality of decisions made by designated officers under Government contracts. *Lyons* v. *United States,* 30 Ct. Cl. 352, 365 (1895); *Collins and Farwell* v. *United States,* 34 Ct. Cl. 294, 332 (1899). Other Federal courts followed the same rule. *Lewis* v. *Chicago S. F. & C. Ry.,* 49 Fed. 708, 710, 713 (C.C.E.D. Mo. 1891); *King Iron Bridge & Mfg. Co.* v. *St. Louis,* 43 Fed. 768 (C.C.E.D. Mo. 1890), *appeal dismissed,* 149 U.S. 769 (1892).

As a disputes clause covering "disputes concerning questions of fact" came into common use in government contracts, the Court of Claims and other courts interpreting that clause uniformly adhered to the view

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concerned with the consequences of the respondent's bookkeeping from one time to another. Neither the petitioner nor anyone else—least of all the Board—would suggest that there would have been any question here if the amortization in the respondent's bookkeeping at the year end 1941 had embraced the production under the CPFF contracts entered into during that year as it had embraced the fixed price contract entered into in June, 1941.

that departmental decisions on questions of interpretation of the contracts were questions of law for the court rather than questions of fact on which administrative decisions were final and conclusive. *Cramp Shipbuilding Co.* v. *United States,* Ct. Cl. No. 48841, April 8, 1952, Slip Opinion pp. 24-25; *Wunderlich* v. *United States,* 117 Ct. Cl. 92, 212-14 (1951), *rev'd on other grounds,* 342 U.S. 98 (1951); *John McShain, Inc.* v. *United States,* 97 Ct. Cl. 281, 295 (1942); *Rust Engineering Co.* v. *United States,* 86 Ct. Cl. 461, 473-74 (1938); *Davis* v. *United States,* 82 Ct. Cl. 334, 346-47 (1936); *Albina Marine Iron Works, Inc.* v. *United States,* 79 Ct. Cl. 714, 722-23 (1934); *Blair* v. *United States,* 164 F. 2d 115, 116 (5th Cir. 1947), *cert. denied,* 333 U.S. 880 (1948); *United States* v. *Lundstrom,* 139 F. 2d 792, 795 (9th Cir. 1943); *Central Nebraska Public Power & Irrigation District* v. *Tobin Quarries, Inc.,* 157 F. 2d 482, 486 (8th Cir. 1946).

The same view has been entertained by the various contracting agencies which have considered the question. The several Boards of Contract Appeals frequently dismiss appeals involving questions of contract interpretation upon the ground that they are not covered by fact disputes clauses. *Fred A. M. deGroot, Inc.,* 1 CCH CONTRACT CASES FED. 148 (WDBCA 1943); *Central Engineering & Contracting Corp.,* 3 CCH CONTRACT CASES FED. 989 (NDBCA 1945); *Ross Engineering Co.,* 3 CCH CONTRACT CASES FED. 1153 (NDBCA 1945); *St. Louis Shipbuilding & Steel Co.,* 4 CCH CONTRACT CASES FED. ¶ 60,143 (NDBCA 1946); *The Arundel Corp.,* 4 CCH CONTRACT CASES FED. ¶ 60,624 (NDBCA 1948). In other cases, as in this very case, *supra* p. 19, such questions have been considered not upon the ground that they were questions of fact but because by memorandum of the Secretary of War.

10 CODE FED. REGS. § 803.318d(g) (Supp. 1944), the Boards were authorized in their discretion to deal with such questions where the contractor so requested. *Waterman Steamship Corp.*, 5 CCH CONTRACT CASES FED. ¶ 61,222 (ASBCA 1951). The Appeal Board of the Office of Contract Settlement consistently holds that whether a cost is allowable under the terms of a contract is a question of law not covered by the fact disputes clause. *Northwest Airlines, Inc.* v. *Army*, 4 OCSAB 11, 13 (1949); *Northwest Airlines Inc.* v. *Army*, 4 OCSAB 16 (1949); *E. I. du Pont de Nemours & Co.* v. *Army*, 3 OCSAB 201, 204 (1949).

This Court has recognized the Court of Claims's uniform interpretation of fact disputes clauses, and that parties to Government contracts make such contracts in the light of that interpretation. In *United States* v. *Moorman*, 338 U.S. 457 (1950), the contract contained both a standard disputes clause, limited to disputes concerning questions of fact, and an additional disputes clause, not so limited, applicable to specified types of controversies. This Court held that the second clause made decisions thereunder binding as to questions of both law and fact and that it was to be interpreted independently of the fact disputes clause. In this connection Mr. Justice Black stated (338 U.S. at 463):

> "The oft-repeated conclusion of the Court of Claims that questions of 'interpretation' are not questions of fact is ample reason why the parties to the contract should provide for final determination of such disputes by a method wholly separate from the fact-limited provisions of Art. 15."

It is submitted that, in view of the long settled rule that the standard fact disputes clause does not give

finality to decisions on questions of interpretation, use of that clause does not indicate an intention of the parties to submit disputes as to such questions to final determination under that clause. Squarely applicable is the statement in the *Moorman* opinion (338 U.S. at 462) that

> "... the intention of parties to submit their contractual disputes to final determination outside the courts should be made manifest by plain language. *Mercantile Trust Co.* v. *Hensey*, 205 U.S. 298, 309."

But even were this Court inclined to limit that rule, perhaps giving finality to administrative decisions on certain questions such as interpretation of technical specifications, the issue in this case is not of that character. As has already been demonstrated, the error of the War Department Board was its reliance on considerations wholly irrelevant under the written contracts. Even where the broadest finality rule is applicable to an administrative agency, if it employs an improper standard or gives weight to facts excluded from consideration by the terms of the statute under which the agency proceeds, there is presented a question of law fully reviewable by the Courts. *Commissioner* v. *Heininger*, 320 U.S. 467, 475 (1943); *ICC* v. *Railway Labor Executives Ass'n*, 315 U.S. 373, 380 (1942); *Powers* v. *Commissioner*, 312 U.S. 259 (1941); *Southern Pacific Co.* v. *ICC*, 219 U.S. 433, 441, 443, 451-52 (1911); *ICC* v. *Delaware L. & W. R.R.*, 220 U.S. 235, 251 (1911).

Of the cases cited by petitioner on page 28 of its brief, *Trust of Bingham* v. *Commissioner*, 325 U.S. 365 (1945), and *Commissioner* v. *Heininger*, 320 U.S. 467

(1943), strongly support respondent's position. Both held that whether specified facts with respect to expenses otherwise deductible precluded allowance of the deductions under the applicable statutory provisions presented a question of law. Of the remaining cases cited by petitioner on this point,[28] only *Peerless Stages, Inc.* v. *Commissioner,* 125 F. 2d 869 (9th Cir. 1942), deals with a question remotely related to this case. But there the issue was clearly factual—that is whether certain expenses were developmental in nature or were ordinary expenses of current business. In the present case there is no such factual issue.

III

The Respondent's Claim for $1,299,856.02 Is Not Barred for Failure to Exhaust Administrative Remedies

One of petitioner's defenses in the lower Court to the respondent's claim for $1,299,856.02, which had been paid by the petitioner but later recouped, was the respondent's alleged failure to exhaust a remedy provided by the contracts before bringing suit. The petitioner's argument both here and below is that, although the first Contracting Officer had approved the claim, if the second Contracting Officer reconsidered and disapproved it in his decision of March, 1945, then since the respondent's appeal from the latter decision to the WarDepartment Board was allegedly limited to the

[28] Since July 4, 1944, when the Board of Contract Appeals was authorized, in its discretion, to consider questions of law under fact disputes clauses, the fact that the Board considers a case is not indicative that the question involved is one of fact. Of the cases cited on page 29 of petitioner's brief, only the *Chrysler Corporation* case was decided prior to July, 1944. The contract in that case provided that disagreements as to reimbursability should be deemed disputes of fact.

claim based on the vouchers for $986,963.63, the respondent must be taken to have waived its right to sue on the claim for $1,299,856.02.

The lower Court unanimously rejected this technical—not to say unrealistic—defense. The opinion of the majority reasons in two steps: (1) that respondent's claim under the contracts had been determined by the first Contracting Officer and that the petitioner had no right to refuse to honor that determination, absent a showing of "gross mistake, or . . . fraud" (R. 112); and (2) that the decision of the second Contracting Officer actually was not a decision on the claim based on the first set of vouchers, which were not before him, but only on the second set of vouchers which he listed in his decision.

A. THE LOWER COURT PROPERLY HELD THAT THE SECOND CONTRACTING OFFICER NEVER ACTED ON THE FIRST SET OF VOUCHERS COVERING RESPONDENT'S CLAIM FOR $1,299,856.02.

The petitioner's argument is founded upon a misreading of the record. It states that it was "permissible" for the second Contracting Officer to "rectify" the decision of the first Contracting Officer "through recoupment and to disallow the 1¼ million dollar claim." (Brief, p. 34) Then it argues that ". . . approval of vouchers by the second contracting officer providing for recoupment" of the payment of that claim resulted in a dispute under the contracts and that therefore the decision of the second Contracting Officer in March, 1945, was a decision of that dispute, which was not appealed by the respondent. (Brief, p. 42) Again, petitioner asserts that a dispute subject the disputes clause of the contracts arose when "the claim was disapproved and that payment was recouped." (Brief, p. 44)

Thus the whole argument proceeds from an assertion that the second Contracting Officer recouped the original payment; the petitioner's brief goes so far, in the last passage quoted above, as to imply that the second Contracting Officer *first* disapproved the respondent's million and a quarter claim and that *then* the payment was recouped. This version of the facts is based upon footnote 10 at page 34 of the petitioner's brief which mis-states the record and the plain findings of the lower Court.

In that footnote the petitioner states that the second Contracting Officer approved the recoupment, as though he were at that time determining that the previous payment to the respondent had been erroneous. Nothing of the sort happened. We have stated the facts in our Statement of the Case. The second Contracting Officer had pending before him a proposal to recoup by deductions from vouchers otherwise due the respondent. He *eliminated* the deductions for amounts which had *already* been recouped by the Finance Officer pursuant to the Comptroller General's exceptions;[29] and as to $125,000 which had been overlooked in the Comptroller General's formal exceptions, but had been covered in previous informal exceptions, the second Contracting Officer approved a recoupment in that amount "in harmony with the

[29] In support of its statement that the second Contracting Officer took action in September, 1944, to "correct the erroneous" payment to the respondent by approving vouchers for recoupment, the petitioner's brief at p. 34, n. 10, cites Tr. 440. There is an isolated passage in the testimony on this page supporting this statement, but the same witness corrected his own error. (Tr. 446-52) The lower Court's findings follow the corrected testimony. (R. 87)

formal notices of exception and suspension previously received by the Finance Officer" from the Comptroller General. (R. 87) In short, the recoupment was entirely at the direction of the Comptroller General, and the Contracting Officer played no part therein except as to a small amount where his participation was purely formal and a mere reflection of the Comptroller General's action. *Supra* at p. 16. Obviously the second Contracting Officer was not passing any judgment on the question of the propriety of the previous payment to the respondent, for at that time he was still awaiting advice from Wright Field, which did not reach him until November, 1944, and on which he did not act until January, 1945. The recoupment occurred in August and September, 1944. *Supra* at pp. 15-16.

In short, the recoupment in this case represented no action by the second Contracting Officer interpreting or applying the contracts. The recoupment was effected solely at the instance of the Comptroller General whereas the contracts do not contain a single provision conferring any function whatsoever upon the Comptroller General. The representative of the petitioner, and the only person authorized to make determinations under the contracts, was the Contracting Officer.

In January and March, 1945, the second Contracting Officer finally rendered a decision. But the only matter then before him was the second set of vouchers. Under Article 6 of the contracts, he is called upon to approve expenditures for reimbursement only upon verification of certified payrolls, invoices, "or other original papers" presented by the contractor and upon such approval the contractor is to be paid. (R. 80) The second set of vouchers had been presented to him and he rendered his decision thereon; his January decision

specified that his findings were directed to such vouchers, which he listed; and in his re-issued decision of March, he again directed his decision specifically to such vouchers. *Supra* at pp. 17-18. The first set of vouchers was not before him. His opinion, it is true, referred to the entire claim; but that can not alter the fact that the only *action* taken by him was the act of refusing to approve the second set of vouchers pending before him. The lower Court properly so held. (R. 113-14)

B. SINCE RESPONDENT APPEALED THE ONLY DECISION MADE BY THE SECOND CONTRACTING OFFICER, THERE IS NO MERIT TO THE CLAIM THAT IT FAILED TO EXHAUST ITS ADMINISTRATIVE REMEDIES.

The petitioner argues, however, that this decision actually was a redetermination of the respondent's right to reimbursement under its first set of vouchers in view of the fact that the decision does refer to the whole claim. Then, in the next breath, the petitioner argues that the respondent's appeal to the War Department Board did not embrace the claim on the first set of vouchers and that therefore respondent did not exhaust its contractual remedy as to that claim and must be denied judgment therefor solely on that account.

This is, indeed, a highly technical view of the matter. If the claim on the first set of vouchers was covered by the decision of the second Contracting Officer, then it was appealed—for the appeal was from that decision, whatever it was. The parties and the Board construed that decision as involving *action*, as distinguished from the expression of opinion, on the second set of vouchers only and therefore the Board limited its decision to the claim on the second set of vouchers. If this Court now holds that the technicality of the matter was that the decision appealed from was a de-

cision on the whole claim, there is no conceivable basis for holding that the respondent failed to take an appeal—for it *did* appeal from that decision.

Furthermore, the War Department Board dealt with the question before it in terms which were just as applicable to the claim on the first set of vouchers as to the claim on the second set of vouchers. There is not a single fact which has been suggested by the petitioner or relied on by the respondent, with respect to the merits of the issue on the two claims, which is in any way different as between the two. The findings of the Board were just as applicable to the first set of vouchers as to the second set. Consequently the whole question of what the appeal covered is about as academic and hyper-technical as a point urged to this Court could possibly be.[30]

C. ABSENT ANY AUTHORIZATION IN THE CONTRACTS, THE SECOND CONTRACTING OFFICER HAD NO POWER TO REVIEW AND REVERSE THE DETERMINATIONS OF HIS PREDECESSOR.

Finally, we suggest that, in any case, the contracts in question do not contemplate that a second Contracting Officer could recall and redetermine a decision of a previous Contracting Officer (absent fraud or gross mistake) even if it is now to be held that that is what the second Contracting Officer purported to do. Article 6 of the contracts provides that:

> "The Government will currently reimburse the Contractor for such expenditures made in accordance with Article 3 hereof as may be approved or ratified by the Contracting Officer . . . ." (R. 80)

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[30] Even in applying the doctrine of primary administrative jurisdiction the courts do not require parties to resort to a useless administrative procedure. Montana National Bank v. Yellowstone County, 276 U.S. 499, 505 (1928); Waite v. Macy, 246 U.S. 606, 608-09 (1918).

The contracts may be searched in vain for any suggestion that long after such approval and reimbursement the whole action may be recalled and done over. Cost reimbursement is to be made *currently*. Current cost reimbursement was a matter of basic importance to war contractors faced with the necessity of financing simultaneously enormous current production and expansion of plant facilities.[31] Surely, where the contract provisions in question were written by the petitioner itself, and where the private contractor played no part in their framing, there is no warrant for implying words that are not there—words which would be contradictory to one of the key articles of the CPFF form. For if the petitioner is correct in its argument, every contractor would be placed in the position of being unable to close its books on a single cent of the huge sums involved until years had gone by. And there would be the constant threat of misunderstandings, disputes, and controversy inherent in a situation where Contracting Officers necessarily change, often with frequency, according to the exigencies of military life.

The contracts provide that where the private contractor does not accept a Contracting Officer's determination he *must* appeal within thirty days to the War Department Board. The contracts give the Government no right to appeal for the very good reason that the Contracting Officer is the Government's representative and speaks for the Government. *United States* v. *Mason & Hanger Co.*, 260 U.S. 323, 325

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[31] Hopkins, *Termination Procedure for Army Air Forces*, N.Y.U. Conference on Problems of Termination and Reconversion 55, 58 (1944).

(1922). Just as the Government has no right to appeal, so it has no right to a far more drastic remedy —the remedy of redetermination *at any time* that a new Contracting Officer feels inclined to review his predecessor's decisions. This unlimited right to reopen and revise the past, against the private contractor's very limited right to appeal once and for all within thirty days, not only would read into the contracts provisions which are not there but would accord a degree of liberality to the author of the contracts—the petitioner—which the author does not receive in ordinary private law. *Mutual Life Insurance Co.* v. *Hurni Packing Co.* 263 U.S. 167, 174 (1923). *See Alcoa Steamship Co.* v. *United States,* 338 U.S. 421, 424-25 (1949). There is no reason for the Government to be so favored. Its drafting facilities are quite adequate to write contract forms for its own protection; the courts should not be called upon, long after the event, to read provisions into its contracts.

United States v. *Bentley,* 107 F. 2d 382 (2d Cir. 1939),[32] particularly relied on by the petitioner, is not apposite here, for that case involved an error of fact in the performance of a purely ministerial function. Unquestionably the Contracting Officer is called upon to perform various ministerial functions, such as making mathematical computations, errors in which he or his successor may be competent to correct later. But no such case is presented here. In acting upon the vouchers submitted to him the first Contracting Officer, as the ultimate repository of the government's con-

[32] United States v. Gudewicz, 45 F. Supp. 787 (E.D. N.Y. 1942), simply followed the rule announced in the *Bentley* case.

tracting authority, was required to exercise judgment.[33] Prior to his decision the matter had been debated by the resident auditors; it was obviously a matter of some importance; and the petitioner has not shown that there was any fact overlooked or any relevant consideration ignored. The case is simply one where a successor Contracting Officer arrived at a different conclusion in an area obviously calling for judgment. When Congress confers upon an administrative agency the authority to determine a matter, and the agency acts, it may not thereafter recall its determination and make a new decision simply because it changes its mind. *Cf. Butte, A. & P. Ry.* v. *United States,* 290 U.S. 127, 134-36 (1933); *United States* v. *Seatrain Lines, Inc.,* 329 U.S. 424, 428-29 (1947).[34] Even more clearly, where parties by contract have sought to create machinery for the disposition of commercial relationships between themselves and have provided for their

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[33] Major Richard H. Demuth, *Administration of CPFF Contracts* 1, 4-6 (1944) (lecture presented at AAF Contracting Officers School, Wright Field, Dayton, Ohio, on file at Army Library); Brown, *The Responsibilities, Functions and Duties of a Contracting Officer,* 12 FED. B. J. 236, 237 (1952). Typical sections of respondent's CPFF contracts obviously required the Contracting Officer to exercise his judgment and discretion. See Articles 3(b), 4(b), 5, 6(a), 7(b), 8(b), 16, 27 and 37 of Contract No. W-535 ac 29318, Exhibit K to the Stipulation of Parties, Plaintiff's Exhibit 1 in the certified record.

[34] A similar rule applies in the case of state administrative agencies and officers, which, absent express authorization, have no power to reconsider and overrule previous decisions. Kaliniek v. Collins, 116 Conn. 1, 163 Atl. 460 (1932); Michelson v. Industrial Commission, 375 Ill. 462, 31 N.E.2d 940 (1941); Connors' Case, 121 Me. 37, 115 Atl. 520 (1921); People v. Wemple, 144 N.Y. 478, 39 N.E. 397 (1895); Hylan v. Waldo, 158 App. Div. 654, 143 N.Y. Supp. 901 (1st Dep't 1913).

determination by a specified person at a specified time (in this case reimbursement was intended to be *current*), it hardly comports with their plan to provide that everything determined shall be subject to redetermination at any time. This is doubtless among the considerations which have led the War Department Board in other cases to deny that successor contracting officers may reverse each other from time to time on the same item. *Bell Aircraft Corp.*, 3 CCH CONTRACT CASES FED. 684 (WDBCA 1945); *Dunn Construction Co.*, 4 CCH CONTRACT CASES FED. ¶ 60,478 (WDBCA 1948); *Continental Aviation & Engineering Corp.*, 4 CCH CONTRACT CASES FED. ¶ 60,525 (WDBCA 1948).

Morgan v. *Hines*, 113 F.2d 849 (D.C. Cir. 1940), relied on by the petitioner, presents a quite different problem. There the power of determining issues was given by statute to the head of the agency and he had delegated certain powers to subordinates with authority to make decisions binding upon claimants, subject to a right of appeal to him. The case holds that the claimant in such a situation cannot complain if the head of the agency, without an appeal by the claimant, re-examines the decision of his subordinate and himself makes the determination which is clearly his to make. Under the contracts here involved, the parties have *agreed* that the Contracting Officer shall determine reimbursable costs. Under such a contract provision it is clear that neither that of[illegible]

34a. Compare the long settled view that arbitrators, or persons performing functions in ordinary private contracts similar to those of a government contracting officer, may not redetermine a matter once it has been passed on. Bayne v. Morris, 1 Wall. 97, 99 (U.S. 1863); Mercury Oil Refining Co. v. Oil Workers Int. Union, 187 F.2d 980, 983 (10th Cir. 1951); St. Charles v. Stookey, 154 Fed. 772, 780 (8th Cir. 1907), cert. denied, 208 U.S. 617 (1908); Annotations, 110 A.L.R. [illegible], 142 (1937); 104 A.L.R. 710 (1936); 54 [illegible] 1255, 1266 (1928).

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Ct. Cl. 218, 247-48 (1930); *Burton Coal Co.* v. *United States*, 60 Ct. Cl. 294, 313-14 (1925), *aff'd on another issue*, 273 U.S. 337 (1927). The Comptroller General is not a party to the contracts here in question and his action stands on no different footing from that of any other stranger to the contracts. *Karno-Smith Co.* v. *United States*, 84 Ct. Cl. 110, 124 (1936); *McShain Co.* v. *United States*, 83 Ct. Cl. 405, 409 (1936); *Albina Marine Iron Works, Inc.* v. *United States*, 79 Ct. Cl. 714, 720 (1934); *Penn Bridge Co.* v. *United States*, 59 Ct. Cl. 892, 896 (1924).

Furthermore, it seems to us that the petitioner cannot repudiate the determination of its Contracting Officer in court. This is not a case where there is a showing of negligence or gross mistake by that Officer. *United States* v. *Sutton Chemical Co.*, 11 F.2d 24 (4th Cir. 1926). Rather, it is a case where representatives of the petitioner, other than that Officer, differ with his point of view. But the representative of the petitioner, for the purpose of the contractual dealings, is the Contracting Officer, not the Comptroller General or the Department of Justice. *Supra*, at p. 62. As we have observed, no mistake has been shown, no action based on misinformation. The case is quite similar to that where this Court held that a determination by the Interstate Commerce Commission of the amount to be paid to a railroad during its transition from government to private ownership had to be honored by the Government regardless of differences of view entertained by other representatives of the Government. *United States* v. *Great Northern Ry.*, 287 U.S. 144, 151-53 (1932).

That the contract provision here in question imports finality to the decision of the first Contracting Officer is the holding of *Stewart & Co.* v. *United States*, 71 Ct.

Cl. 126 (1930). The contract there provided that the contractor should be reimbursed "for such of its actual net expenditures in the performance of said work as may be approved or ratified by the contracting officer." The General Accounting Office disallowed certain amounts approved by the Contracting Officer and paid by the disbursing officers and attempted to recover them by counterclaim against a judgment in the contractor's favor. The court held that the determination of the Contracting Officer was binding on the Government, saying (71 Ct. Cl. at 129-30):

> "If the decision of the contracting officer as shown by his approval or ratification was not final, his act in so doing was merely an idle gesture, for the contention of defendant is that notwithstanding such approval it can raise any objection to these items that it sees fit. We do not think the contract can properly be so construed. In fact to so construe it would have the effect to strike from the contract the words 'as may be approved or ratified by the contracting officer,' for they become absolutely useless. . . . The actions of the parties . . . show very plainly that both parties considered that, subject to other provisions in the contract having no bearing on this particular case, the decision made by the contracting officer was final, and such would be the ordinary meaning given to the provision under consideration. It should also be noted in this connection that there is neither allegation nor proof of fraud, bad faith, or palpable disregard of the rights of either party by the contracting officer. So far as it appears from the evidence, he exercised the authority given him with an honest purpose to carry out the

> intention of the parties to the contract and his action was an exercise of the power conferred upon him by that instrument. He discharged that duty by the mutual assent of both parties. The terms by which the power was conferred and the duty imposed are clear and precise and they are susceptible of no other interpretation than that the action of the contracting officer in the matter of expenditures was intended to be conclusive, in the absence of fraud, such gross mistake as would necessarily imply bad faith, or a failure to exercise an honest judgment."

The Court found finality not in any express language to that effect but in the contract provision above quoted. For the reasons already indicated, we believe that the Court's conclusion was correct. It is not the presence in the contract of magic words such as "final and binding", but the intention indicated by a reading of the contract as a whole which is determinative. Where the contract evidences an intention that a specified matter shall be finally decided by a particular officer or agency, this Court holds that the decision of that officer or agency must be recognized as binding, notwithstanding the absence of express language to that effect. *Kihlberg* v. *United States*, 97 U.S. 398 (1878); *United States* v. *Gleason*, 175 U.S. 588 (1900); *Goltra* v. *Weeks*, 271 U.S. 536, 547-48 (1926); *Graham Mfg Co.* v. *United States*, 91 F. Supp. 715 (N.D. Cal. 1950). Furthermore, finality has been given decisions under such contract clauses notwithstanding the presence in the contract of other clauses expressly providing for finality on different matters. *United States* v. *Gleason, supra* at 604. It is submitted that the decisions of the Office of Contract Settlement Appeal Board

cited by the petitioner (Brief, p. 37) are not a correct statement of the law.

The petitioner argues that it would be inequitable for the Government to be bound when the contractor is given the right to appeal under the disputes clause of the contracts on issues of fact and to invoke judicial determination of questions of contract interpretation. But the very fact that the Government is given no right to appeal under the disputes clause demonstrates that it was not intended that the two parties were to be treated in the same way. The interpretation urged by the petitioner would give the Government an unlimited right to repudiate its Contracting Officers' determinations, while the private contractor is held to a precise procedure which must be pursued within a brief period of time or be lost forever. *Barnes Construction Co.*, 3 CCH CONTRACT CASES FED. 553 (WDBCA 1945); *Goldschmidt & Bethune Co.*, 3 CCH CONTRACT CASES FED. 381 (WDBCA 1945); *N. P. Severin Co.*, 2 CCH CONTRACT CASES FED. 771 (WDBCA 1944); *A. C. Campbell Co.*, 1 CCH CONTRACT CASES FED. 776 (WDBCA 1943); *John T. Brady & Co.*, 1 CCH CONTRACT CASES FED. 772 (WDBCA 1943). The more reasonable interpretation is that the difference in treatment means that the Government is to be bound by the determinations of its own Contracting Officer, appointed, advised, and disciplined by it.

An alternative view is that the determinations of its Contracting Officer will bind the Government on issues of fact, with both parties free to invoke judicial determination of issues of contract interpretation. The contractor may invoke the courts on disputes of law because the contracts do not foreclose that avenue; it is only on fact disputes that the War Department process is conclusive. It might be argued that the

Government is similarly free to seek the courts' decisions of questions of contract interpretation, and that the failure to provide the Government with the remedy on issues of fact which is extended to the contractor under the fact disputes clause implies that on such issues—but only on such issues—the Contracting Officer's determinations settle the question as to the Government. This suggestion is not as consistent with the contractual pattern as is the view that the Government is bound both on fact and law—but it at least has the merit of preserving a contractual relationship which does not weigh the scales wholly against the contractor and in favor of the Government. If this latter view is adopted, and if the petitioner is correct in its argument that the question in this case is one of fact, it follows that the petitioner is bound by the first Contracting Officer's decision on the first set of vouchers.

Of course, if we are correct in our argument that the dispute here is one of law, the petitioner's plea that the contractual remedy for fact disputes has not been exhausted can have no application.[35] In no event, however, can there be any merit in the claim that the respondent has tripped over a technicality; the essence of the matter is that the respondent appealed from the decision of the second Contracting Officer—whatever it was—and that is all that it could have done.

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[35] United States v. Lundstrom, 139 F. 2d 792 (9th Cir. 1943); Cramp Shipbuilding Co. v. United States, Ct. Cl. No. 48841, April 8, 1952, Slip Opinion p. 25; Pottsville Casting & Machine Shops, Inc. v. United States, Ct. Cl. No. 49092, December 4, 1951, Slip Opinion pp. 26-27; Paretta Contracting Co. v. United States, 109 Ct. Cl. 324, 351-52 (1947), *cert. denied*, 333 U.S. 832 (1948).

CONCLUSION

Wherefore, it is respectfully submitted that the judgment of the Court below should be affirmed.

Respectfully submitted,

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OCTOBER 9, 1952.

APPENDIX A

PERTINENT PROVISIONS OF T. D. 5000, 1940-2 CUM. BULL. 397, 404-409:

SEC. 26.9. *Cost of performing a contract or subcontract.*—(a) *General rule.*—The cost of performing a particular contract or subcontract shall be the sum of (1) the direct costs, including therein expenditures for materials, direct labor and direct expenses, incurred by the contracting party in performing the contract or subcontract; and (2) the proper proportion of any indirect costs (including therein a reasonable proportion of management expenses) incident to and necessary for the performance of the contract or subcontract.

(b) *Elements of cost.*—No definitions of the elements of cost may be stated which are of invariable application to all contractors and subcontractors. In general, the elements of cost may be defined for purposes of the Act as follows:

(1) Manufacturing cost, which is the sum of factory cost (see paragraph (c) of this section) and other manufacturing cost (see paragraph (d) of this section);

(2) Miscellaneous direct expenses (see paragraph (e) of this section);

(3) General expenses, which are the sum of indirect engineering expenses, usually termed "engineering overhead" (see paragraph (f) of this section) and expenses of distribution, servicing and administration (see paragraph (g) of this section); and

(4) Guarantee expenses (see paragraph (h) of this section).

(c) *Factory cost.*—Factory cost is the sum of the following:

(1) *Direct materials.*—Materials, such as those purchased for stock and subsequently issued for contract operations and those acquired under subcontracts, which become a component part of the finished product or which are used directly in fabricating, converting or processing such materials or parts.

(2) *Direct productive labor.*—Productive labor, usually termed "shop labor," which is performed on and is properly chargeable directly to the article manufactured or constructed pursuant to the contract or subcontract, but which ordinarily does not include direct engineering labor (see subparagraph (3) of this paragraph).

(3) *Direct engineering labor.*—The compensation of professional engineers and other technicists (including reasonable advisory fees), and of draftsmen, properly chargeable directly to the cost of the contract or subcontract.

(4) *Miscellaneous direct factory charges.*—Items which are properly chargeable directly to the factory cost of performing the contract or subcontract but which do not come within the classifications in subparagraphs (1), (2), and (3) of this paragraph, as for example, royalties which the contracting party pays to another party and which are properly chargeable to the cost of performing the contract or subcontract (but see paragraph (d) of this section).

(5) *Indirect factory expenses.*—Items, usually termed "factory overhead," which are not directly chargeable to the factory cost of performing the contract or subcontract but which are properly incident to and necessary for the performance of the contract or subcontract and consist of the following:

(A) *Labor.*—Amounts expended for factory labor, such as supervision and inspection, clerical labor, timekeeping, packing and shipping, stores supplies, services of tool crib attendants, and services in the factory employment bureau, which are not chargeable directly to productive labor of the contract or subcontract.

(B) *Materials and supplies.*—The cost of materials and supplies for general use in the factory in current operations, such as shop fuel, lubricants, heat-treating, plating, cleaning and anodizing supplies, nondurable tools and gauges, stationery (such as time tickets and other forms), and boxing and wrapping materials.

(C) *Service expenses.*—Factory expenses of a general nature, such as those for power, heat and light (whether purchased or produced), ventilation and air-conditioning and operation and maintenance of general plant assets and facilities.

(D) *Fixed charges and obsolescence.*—Recurring charges with respect to property used for manufacturing purposes of the contract or subcontract, such as premiums for fire and elevator insurance, property taxes, rentals and allowances for depreciation of such property, including maintenance and depreciation of reasonable stand-by equipment; and depreciation and obsolescence of special equipment facilities necessarily acquired primarily for the performance of the contract or subcontract, except special additional equipment and facilities with respect to which the Secretary of the department concerned has made a certification binding upon the Commissioner of Internal Revenue, pursuant to section 4 of the Act, in the case of such contract or subcontract. See Executive Order No. 8465 and Joint Rules issued under such Order (page 385, this Bulletin). In making allowances for depreciation, consideration shall be given to the number and length of shifts.

(E) *Miscellaneous indirect factory expenses.*—Miscellaneous factory expenses not directly chargeable to the factory cost of performing the contract or subcontract, such as purchasing expenses; ordinary and necessary expenses of rearranging facilities within a department or plant; employees' welfare expenses; premiums or dues on compensation insurance; employers' payments to unemployment, old age and social security Federal and State funds not including payments deducted from or chargeable to employees or officers; pensions and retirement payments to factory employees; factory accident compensation (as to self-insurance, see paragraph (g) of this section); but not including any amounts which are not incident to services, operations, plant, equipment or facilities involved in the performance of the contract or subcontract.

(d) *Other manufacturing cost.*—Other manufacturing cost as used in paragraph (b) of this section includes items of manufacturing costs which are not properly or satisfactorily chargeable to factory costs (see paragraph (c) of this section) but which upon a complete showing of all pertinent facts are properly to be included as a cost of performing the contract or subcontract, as for instance, payments of royalties and amortization of the cost of designs purchased and patent rights over their useful life; and "deferred" or "unliquidated" experimental and de-

velopment charges. For example, in case experimental and development costs have been properly deferred or capitalized and are amortized in accordance with a reasonably consistent plan, a proper portion of the current charge, determined by a ratable allocation which is reasonable in consideration of the pertinent facts, may be treated as a cost of performing the contract or subcontract. In the case of general experimental and development expenses which may be charged off currently, a reasonable portion thereof may be allocated to the cost of performing the contract or subcontract. If a special experimental or development project is carried on in pursuance of a contract, or in anticipation of a contract which is later entered into, and the expense is not treated as a part of general experimental and development expenses or is not otherwise allowed as a cost of performing the contract, there clearly appearing no reasonable prospect of an additional contract for the type of article involved, the entire cost of such project may be allowed as a part of the cost of performing the contract.

(e) *Miscellaneous direct expenses.*—Miscellaneous direct expenses as used in paragraph (b) of this section include—

(1) *Cost of installation and construction.*—Cost of installation and construction includes the cost of materials, labor, and expenses necessary for the erection and installation prior to the completion of the contract and after the delivery of the product or material manufactured or constructed pursuant to the contract or subcontract.

(2) *Sundry direct expenses.*—Items of expense which are properly chargeable directly to the cost of performing a contract or subcontract and which do not constitute guarantee expenses (see paragraph (h) of this section) or direct costs classified as factory cost or other manufacturing cost (see paragraphs (c) and (d) of this section), such as premiums on performance or other bonds required under the contract or subcontract; State sales taxes imposed on the contracting party; freight on outgoing shipments; fees paid for wind tunnel and model basin tests; demonstration and test expenses; crash insurance premiums; traveling expenses. In order for any such item to be allowed as a charge directly to the cost of performing a contract or sub-

contract, (1) a detailed record shall be kept by the contracting party of all items of a similar character, and (2) no item of a similar character which is properly a direct charge to other work shall be allowed as a part of any indirect expenses in determining the proper proportion thereof chargeable to the cost of performing the contract or subcontract. As to allowable indirect expenses, see paragraphs (e) (5), (f), (g), and (j) of this section.

(f) *Indirect engineering expenses.*—Indirect engineering expenses, usually termed "engineering overhead," which are treated in this section as a part of general expenses in determining the cost of performing a contract or subcontract (see paragraph (b) of this section), comprise the general engineering expenses which are incident to and necessary for the performance of the contract or subcontract, such as the following:

(1) *Labor.*—Reasonable fees of engineers employed in a general consulting capacity, and compensation of employees for personal services to the engineering department, such as supervision, which is properly chargeable to the contract or subcontract, but which is not chargeable as direct engineering labor (see paragraph (e) (3) of this section).

(2) *Material.*—Supplies for the engineering department, such as paper and ink for drafting and similar supplies.

(3) *Miscellaneous expenses.*—Expenses of the engineering department, such as (A) maintenance and repair of engineering equipment, and (B) services purchased outside of the engineering department for blue printing, drawing, computing, and like purposes.

(g) *Expenses of distribution, servicing, and administration.*—Expenses of distribution, servicing, and administration, which are treated in this section as a part of general expenses in determining the cost of performing a contract or subcontract (see paragraph (b) of this section), comprehend the expenses incident to and necessary for the performance of the contract or subcontract, which are incurred in connection with the distribution and general servicing of the contracting party's products and the general administration of the business, such as—

(1) *Compensation for personal services of employees.*—The salaries of the corporate and general executive officers

and the salaries and wages of administrative clerical employees and of the office services employees such as telephone operators, janitors, cleaners, watchmen, and office equipment repairmen.

(2) *Bidding and general selling expenses.*—Bidding and general selling expenses which by reference to all the pertinent facts and circumstances reasonably constitute a part of the cost of performing a contract or subcontract. The treatment of bidding and general selling expenses as a part of general expenses in accordance with this paragraph is in lieu of any direct charges which otherwise might be made for such expenses. The term "bidding expenses" as used in this section includes all expenses in connection with preparing and submitting bids.

(3) *General servicing expenses.*—Expenses which by reference to all the pertinent facts and circumstances reasonably constitute a part of the cost of performing a contract or subcontract and which are incident to delivered or installed articles and are due to ordinary adjustments or minor defects; but including no items which are treated as a part of guarantee expenses (see paragraph (h) of this section) or as a part of direct costs, such as direct materials, direct labor, and other direct expense.

(4) *Other expenses.*—Miscellaneous office and administrative expenses, such as stationery and office supplies; postage; repair and depreciation of office equipment; contributions to local charitable or community organizations to the extent constituting ordinary and necessary business expenses; employees' welfare expenses; premiums and dues on compensation insurance; employers' payments to unemployment, old age, and social security Federal and State funds, not including payments deducted from or chargeable to employees or officers; pensions and retirement payments to administrative office employees and accident compensation to office employees (as to self-insurance, see the following subparagraph).

Subject to the exception stated in this subparagraph, in cases where a contracting party assumes its own insurable risks (usually termed "self-insurance"), losses and payments will be allowed in the cost of performing a contract or subcontract only to the extent of the actual losses suffered or payments incurred during, and in the course

of, the performance of the contract or subcontract and properly chargeable to such contract or subcontract. If, however, a contracting party assumes its own insurable risks (a) for compensation paid to employees for injuries received in the performance of their duties, or (b) for unemployment risks in States where insurance is required, there may be allowed as a part of the cost of performing a contract or subcontract a reasonable portion of the charges set up for purposes of self-insurance under a system of accounting regularly employed by the contracting party, as determined by the Commissioner of Internal Revenue, at rates not exceeding the lawful or approved rates of insurance companies for such insurance, reduced by amounts representing the acquisition cost in such companies, provided the contracting party adopts and consistently follows this method with respect to self-insurance in connection with all contracts and subcontracts subsequently performed by him.

Allowances for interest on invested capital are not allowable as costs of performing a contract or subcontract.

Among the items which shall not be included as a part of the cost of performing a contract or subcontract or considered in determining such cost, are the following: Entertainment expenses; dues and memberships other than of regular trade associations; donations except as otherwise provided above; losses on other contracts; profits or losses from sales or exchanges of capital assets; extraordinary expenses due to strikes, or lockouts; fines and penalties; amortization of unrealized appreciation of values of assets; expenses, maintenance and depreciation of excess facilities (including idle land and building, idle parts of a building, and excess machinery and equipment) vacated or abandoned, or not adaptable for future use in performing contracts or subcontracts; increases in reserve accounts for contingencies, repairs, compensation insurance (except as above provided with respect to self-insurance) and guarantee work; Federal and State income and excess-profits taxes and surtaxes; cash discount earned up to 1 per cent of the amount of the purchase, except that all discounts on subcontracts subject to the Act will be considered; interest incurred or earned; bond discount or finance charges; premiums for life insurance on the lives of officers; legal and accounting fees in connection with reorganizations, security issues, capital stock issues, and the prosecution

of claims against the United States (including income tax matters); taxes and expenses on issues and transfers of capital stock; losses on investments; bad debts; and expenses of collection and exchange.

In order that the cost of performing a contract or subcontract may be accounted for clearly, the amount of any excess profits repayable to the United States pursuant to the Act should not be charged to or included in such cost.

(h) *Guarantee expenses.*—Guarantee expenses include the various items of factory cost, other manufacturing cost, cost of installation and construction, indirect engineering expenses, and other general expenses (see paragraphs (e) to (g), inclusive, of this section) which are incurred after delivery or installation of the article manufactured or constructed pursuant to the particular contract or subcontract and which are incident to the correction of defects or deficiencies which the contracting party is required to make under the guarantee provisions of the particular contract or subcontract. If the total amount of such guarantee expenses is not ascertainable at the time of filing the report required to be filed with the collector of internal revenue (see section 26.16 of these regulations) and the contracting party includes any estimated amount of such expenses as part of the claimed total cost of performing the contract or subcontract, such estimated amount shall be separately shown on the report and the reasons for claiming such estimated amount shall accompany the report; but only the amount of guarantee expenses actually incurred will be allowed. If the amount of guarantee expenses actually incurred is greater than the amount (if any) claimed on the report and the contracting party has made an overpayment of excess profit, a refund of the overpayment shall be made in accordance with the provisions of section 26.19 of these regulations. If the amount of guarantee expenses actually incurred is less than the amount claimed on the report and an additional amount of excess profit is determined to be due, the additional amount of excess profit shall be assessed and paid in accordance with the provisions of section 26.19 of these regulations.

(i) *Unreasonable compensation.*—The salaries and compensation for services which are treated as a part of the cost of performing a contract or subcontract include rea-

sonable payments for salaries, bonuses, or other compensation for services. As a general rule, bonuses paid to employees (and not to officers) in pursuance of a regularly established incentive bonus system may be allowed as a part of the cost of performing a contract or subcontract. The test of allowability is whether the aggregate compensation paid to each individual is for services actually rendered incident to, and necessary for, the performance of the contract or subcontract, and is reasonable. Excessive or unreasonable payments whether in cash, stock, or other property ostensibly as compensation for services shall not be included in the cost of performing a contract or subcontract.

(j) *Allocation of indirect costs.*—No general rule applicable to all cases may be stated for ascertaining the proper proportion of the indirect costs to be allocated to the cost of performing a particular contract or subcontract. Such proper proportion depends upon all the facts and circumstances relating to the performance of the particular contract or subcontract. Subject to a requirement that all items which have no relation to the performance of the contract or subcontract shall be eliminated from the amount to be allocated, the following methods of allocation are outlined as acceptable in a majority of cases:

(1) *Factory indirect expenses.*—The allowable indirect factory expenses (see paragraph (c) (5) of this section) shall ordinarily be allocated or "distributed" to the cost of the contract or subcontract on the basis of the proportion which the direct productive labor (see paragraph (c) (2) of this section) attributable to the contract or subcontract bears to the total direct productive labor of the production department or particular section thereof during the period within which the contract or subcontract is performed, except that if the indirect factory expenses are incurred in different amounts and in different proportions by the various producing departments consideration shall be given to such circumstances to the extent necessary to make a fair and reasonable determination of the true profit and excess profit.

(2) *Engineering indirect expenses.*—The allowable indirect engineering expenses (see paragraph (f) of this section) shall ordinarily be allocated on "distributed" to the cost of the contract or subcontract on the basis of the

proportion which the direct engineering labor attributable to the contract or subcontract (see paragraph (c) (3) of this section) bears to the total direct engineering labor of the engineering department or particular section thereof during the period within which the contract or subcontract is performed. If the expenses of the engineering department are not sufficient in amount to require the maintenance of separate accounts, the engineering indirect costs may be included in the indirect factory expenses (see paragraph (c) (5) of this section) and allocated or distributed to the cost of performing the contract or subcontract as a part of such expenses, provided the proportion so allocated or distributed is proper under the facts and circumstances relating to the performance of the particular contract or subcontract.

(3) *Administrative expenses (or "overhead").*—The allowable expenses of administration (see paragraph (g) of this section) or other general expenses except indirect engineering expenses, bidding and general selling expenses, and general servicing expenses shall ordinarily be allocated or distributed to the cost of performing a contract or subcontract on the basis of the proportion which the sum of the manufacturing cost (see paragraph (b) of this Section) and the cost of installation and construction (see paragraph (e) of this section) attributable to the particular contract or subcontract bears to the sum of the total manufacturing cost and the total cost of installation and construction during the period within which the contract or subcontract is performed.

(4) *Bidding, general selling, and general servicing expenses.*—The allowable bidding and general selling expenses and general servicing expenses (see paragraph (g) (2) and (3) of this section) shall ordinarily be allocated or distributed to the cost of performing a contract or subcontract on the basis of—

(i) The proportion which the contract price of the particular contract or subcontract bears to the total sales made (including contracts or subcontracts completed) during the period within which the particular contract or subcontract is performed, or

(ii) The proportion which the sum of the manufacturing cost (see paragraph (b) of this section) and the cost of installation and construction (see paragraph

(e) of this section) attributable to the particular contract or subcontract bears to the sum of the total manufacturing cost and the total cost of installation and construction during the period within which the contract or subcontract is performed.

except that special consideration shall be given to the relation which certain classes of such expenses bear to the various classes of articles produced by the contracting party in each case in which such consideration is necessary in order to make a fair and reasonable determination of the true profit and excess profit. See section 26.14 of these regulations.

APPENDIX B

Pertinent Provisions of the CPFF Countries

With minor variations in phrasing each of the CPFF contracts contain provisions substantively identical to those in Contract No. W 535 ac-20910 as follows:

"Article 3—Consideration

"(a) The Government will pay the Contractor upon satisfactory delivery of all items specified in the contract, subject to reimbursement for cost as outlined in Article 6 hereof, the cost, plus a fixed fee of . . . being . . . percent of the total estimated cost . . . . This estimated cost and the fixed fee are subject to increases or decreases resulting from authorized changes as provided in Article 5 hereof. Provided, however, that there shall be no adjustment in the amount of the fixed-fee as provided herein, nor shall there be any claim for increased compensation, because of any errors and/or omissions made in computing the original estimated cost of the work or where the estimated cost varies from the actual cost.

"(b) For the purpose of determining the amount payable under this contract, allowable items of cost will be determined by the Contracting Officer in accordance with Regulations for determination of the cost of performing a contract as promulgated by the Treasury Department in Section 26.9 of Chapter 1 of Title 26 of Code of Federal Regulations, as contained in T. D. 5000 and approved by the Secretary of War August 2, 1940. It being understood and agreed without limiting the generality of the foregoing, that

"(1) All costs which have been incurred by the Contractor in anticipation of this contract and prior to the signing thereof, and which if incurred after the signing of this contract, would have been considered as allowable items of cost within the meaning of said regulations, shall be considered as allowable items of cost incurred hereunder.

"(2) Any cost incurred by the Contractor under the terms of this Contract which would constitute an allowable item of cost under the provisions of paragraph (b) of this article shall be included in determining the amount payable under this contract, notwithstanding any provisions contained in the specifications or other documents incorporated

in this contract by reference, designating services to be performed or materials to be furnished by the Contractor at its expense or without cost to the Government.

"In the event that prior to final settlement under this contract such regulations [T. D. 5000] be amended so as to provide for additional allowable items of cost such additional items shall be considered allowable items hereunder.*

"(c) The Contractor shall, to the extent of his ability, procure materials and services at the most advantageous prices available with due regard to securing prompt delivery of satisfactory materials, take all cash and trade discounts, rebates, allowances, credits, salvage, commissions and bonifications, and when unable to take advantage of such benefits he shall promptly notify the Contracting Officer to that effect and the reason therefor. In determining the actual net cost of articles and materials of every kind required for the purpose of this contract, there shall be deducted from the gross cost thereof all cash and trade discounts, rebates, allowances, credits, salvage, commissions and bonifications which have accrued to the benefit of the Contractor or would have so accrued except for the fault or neglect of the Contractor. Such benefits lost through no fault or neglect on the part of the Contractor, or lost through fault of the Government, shall not be deducted from gross costs."

* * *

"ARTICLE 6—PAYMENTS

"(a) *Reimbursement for Cost.* The Government will currently reimburse the Contractor for such expenditures made in accordance with Article 3 as may be approved or ratified and upon certification to and verification by the Contracting Officer of the original signed payrolls for labor, the original paid invoices for materials or other original papers. Provided, however, that subject to the requirement of paragraph (c) of Article 7 hereof, in respect of

* In the case of Contracts Nos. W 535 ac-29318 and W 535 ac-40071 the provision specifically covers amendments of T. D. 5000 "before or after" the effective date of the contract. The provision in Contract No. DA-W 535 ac-156 refers to changes "on or before" the effective date. It is apparent that this is a typographical error, since such language deprives the provision of any real effect.

the maintenance so far as practicable of a complete separate system of accounts for work under this contract, in the event it be impracticable to furnish the Contracting Officer with original signed payrolls for labor, original paid invoices for materials, or other original papers, the Contractor shall furnish evidence in a form satisfactory to the Contracting Officer, covering expenditures to be reimbursed under this article. Generally, reimbursement will be made weekly but may be made at more frequent intervals if the conditions so warrant.

"(b) *Payment of the Fixed Fee.* Ninety per cent (90%) of the fixed fee of Six per cent (6%) set forth in paragraph (a) of Article 3 hereof, shall be paid as it accrues, in monthly installments based upon the percentage of the completion of the work as determined from estimates made and approved by the Contracting Officer. Upon completion of the work and its final acceptance, any unpaid balance of the fee, including the additions thereto, if any, to which the Contractor may be entitled, as provided in said paragraph (a) of Article 3, shall be paid to the Contractor."

Contracts No. W 535 ac-20910, DA-W 535 ac-156 and W 535 ac-29318 contain this additional section in Article 6:

"(c) *Advances*—Advance payments may be made from time to time for the supplies called for, when the Secretary of War deems such action necessary in the interest of national defense: *Provided, However,* That the total amount of money so advanced shall not exceed thirty per centum (30%) of the contract price of the articles called for that such advances, as made, shall be upon such terms and conditions and with such adequate security as the Secretary of War shall prescribe."

Contract No. W 535 ac-40071 contains these additional sections in Article 6:

"(c) As of the date of the execution of this contract there has been allotted for it the total sum of .... This sum may be increased from time to time by the Government solely in its discretion. Upon the making of any such increase the Contracting Officer shall notify the Contractor in writing of the amount of such increase.

"(d) Notwithstanding any other provisions of this contract the Contractor shall not be bound to take any action in connection with the performance of this contract that would

cause the amount for which the Government will be obligated hereunder to exceed the sum allotted for this contract, and the obligation of the Contractor to proceed with the performance of this contract shall be limited accordingly. If at any time the Contractor has reason to believe that the amount to be expended by it in the next succeeding 30 days, when added to all previous expenditures and to the total amount of the Contractor's fixed-fee, will exceed the sum allotted for this contract, it shall notify the Contracting Officer to that effect, giving a new estimate of its total expenditures under this contract, so that an appropriate increase may be made in the sum allotted for this contract. Anything in this contract to the contrary notwithstanding, the Government shall not be obligated to pay to the Contractor either for reimbursement of expenditures or fixed fee or otherwise any amount in excess of the sum allotted for this contract; provided, however, that if the Contractor makes any expenditures for which funds are not allotted, the Contracting Officer may ratify such expenditures when funds are allotted."

Contract No. DA-W 535 ac-156 contains the following disputes clause:

"ARTICLE 16—DISPUTES

"Except as otherwise specifically provided in this contract, all disputes concerning questions of fact arising under this contract shall be decided by the Contracting Officer, subject to written appeal by the Contractor within 30 days to the head of the department concerned or his duly authorized representative, whose decision shall be final and conclusive upon the parties hereto. In the meantime the Contractor shall diligently proceed with performance."

Contracts Nos. W 535 ac-20910 and W 535 ac-29318 originally contained the same short form clause, but apparently supplemental agreements omitted from the certified record substituted the following clause, also contained in Contract No. W 535 ac-40071 (see R. 28):

"ARTICLE 16—DISPUTES

"Except as otherwise specifically provided in this contract, all disputes concerning questions of fact which may arise under this contract, and which are not disposed of by mutual agreement, shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail

a copy thereof to the Contractor at his address shown herein. Within 30 days from said mailing the Contractor may appeal in writing to the Secretary of War, whose written decision or that of his designated representative or representatives thereon shall be final and conclusive upon the parties hereto. The Secretary of War may, in his discretion, designate an individual, or individuals, other than the Contracting Officer, or a board as his authorized representative to determine appeals under this Article. The Contractor shall be afforded an opportunity to be heard and offer evidence in support of his appeal. The president of the board, from time to time, may divide the board into divisions of one or more members and assign members thereto. A majority of the members of the board or of a division thereof shall constitute a quorum for the transaction of the business of the board or of a division, respectively, and the decision of a majority of the members of the board or of a division shall be deemed to be the decision of the board or of a division, as the case may be. If a majority of the members of a division are unable to agree on a decision or if within 30 days after a decision by a division, the board or the president thereof directs that the decision of the division be reviewed by the board, the decision will be so reviewed, otherwise the decision of a majority of the members of a division shall become the decision of the board. If a majority of the members of the board is unable to agree upon a decision, the president will promptly submit the appeal to the Under Secretary of War for his decision upon the record. A vacancy in the board or in any division thereof shall not impair the powers nor affect the duties of the board or division nor of the remaining members of the board or division, respectively. Any member of the board, or any examiner designated by the president of the board for that purpose, may hold hearings, examine witnesses, receive evidence and report the evidence to the board or to the appropriate division, if the case is pending before a division. Pending decision of a dispute hereunder the Contractor shall diligently proceed with the performance of this contract. Any sum or sums allowed to the Contractor under the provisions of this Article shall be paid by the United States as part of the cost of the articles or work herein contracted for and shall be deemed to be within the contemplation of this contract."

APPENDIX C

PERTINENT EXHIBITS

Plaintiff's Exhibit 25

COPY

WAR DEPARTMENT
ARMY AIR FORCES

Material Center
Eastern Procurement Division
Office of the Army Air Forces Representative
Bell Aircraft Corporation, Niagara Frontier Division

Capt. H. B. Davies
bmd: Contracting Officer
10 January 1945

SUBJECT: Amortization Costs Incurred
on Experimental Contracts

To: Bell Aircraft Corporation
2050 Elmwood Avenue
Buffalo 7, New York

1. Forwarded herewith is a copy of a decision made by the Chief of the Procurement Division of the Air Technical Service Command on the reimbursement of amortization of development and experimental expense over CPFF contracts.

2. This office incorporates the decision of the Chief of the Procurement Division as a finding of facts in denying reimbursement to the contractor for this expenditure, as requested on Audit Bureau Vouchers, as follows:

Voucher No.	Contract No.	Amount
8449	W535 ac 40071	$ 29,102.96
8450	"	67,973.28
8445	"	11,774.48
8446	"	27,500.64
8447	"	29,880.52
8448	"	69,789.36
8439	W535 ac 20910	20,495.76
8440	"	8,775.32
8441	"	1,037.76
8442	"	444.32

Voucher No.	Contract No.	Amount
8443	W535 ac 29318	499.86
8444	"	722.02
*70-131	W535 ac 20910	22,874.70
*70-130	"	35,582.98
*70-72	W535 ac 40071	39,395.44
*70-128	W535 ac 20910	72,676.10
*70-129	"	113,052.07
*70-71	W535 ac 40071	125,164.76
10619	DA W535 ac 156	4,371.50
10620	W535 ac 29318	55,916.00
10621	W535 ac 40041	13,979.04
10606	DA W535 ac 156	13,888.85
10607	W535 ac 29318	177,652.86
10608	W535 ac 40041	44,413.35

NOTE: * Terminated Contracts.

/s/ H. B. DAVIES
H. B. DAVIES
Captain, Air Corps
Contracting Officer

cc: Resident Auditor
Incl. (1)
1. WF ltr. 11.13.44

COPY

ARMY AIR FORCES
HEADQUARTERS

AIR TECHNICAL SERVISCE COMMAND

TSBCO3/JGH/aed
Wright Field, Dayton, Ohio
13 November 1944

SUBJECT: Amortization Costs Incurred on Experimental Contracts

TO: District Supervisor
Eastern Procurement District
Air Technical Service Command
67 Broad Street
New York 4, New York
Attention: Chief, Contract Section

1. Reference is made to letter dated 10 December 1943 from the Bell Aircraft Corporation Resident Auditor to the District Auditor, Eastern Procurement District, sub-

ject "Amortization of Losses on Fixed Price Contracts" and to an audit report attached thereto prepared by the Resident Auditor concerning the manner in which Bell Aircraft Corporation has amortized over certain fixed price contracts with the United States Government and with the British Government the sum of $3,422,870.23. The said letter of 10 December 1943, the report attached thereto, and the opinion of the District Auditor to the Resident Auditor on the matter dated 30 September 1943 together with a statement by Bell Aircraft Corporation dated 5 January 1944 concerning the same matter were forwarded by your office to this Headquarters by 1st Indorsement dated 20 January 1944, subject as above, for the views of this office as to the right of Bell to be reimbursed under its CPFF contracts for any portion of the said amount.

2. It appears from such information forwarded to this Headquarters that during the years 1938, 1939, and 1940, Bell Aircraft Corporation expended a sum of $3,422,870.23 in connection with the development of experimental airplanes XP-39, XFM-1 and XFL-2, and that the prices of fixed price experimental contracts held by Bell with the Government were insufficient to cover any portion of such expenditures. It further appears that the said sum of $3,422,870.23 was fully amortized by Bell Aircraft Corporation over certain fixed price production contracts between it and the United States Government and between it and the British Government during the years 1940, 1941, and 1942. It also appears from 5th Indorsement from the Resident Auditor, Bell Aircraft Corporation, to the Contracting Officer, Bell Aircraft Corporation dated 27 July 1944, concurred in by the Contracting Officer at Bell by 6th Indorsement dated 28 July 1944, that Bell Aircraft Corporation earned total aggregate net profits applicable to the said fixed price production contracts of $17,590,201.57. The profits earned on the said fixed price production contracts, therefore, are more than enough to recover for Bell Aircraft Corporation the total amount of the expenditures of $3,422,870.23 referred to above, and were so treated on the books of Bell Aircraft Corporation.

3. It appears that in 1943 as a result of conferences with the Internal Revenue Department, Bell Aircraft Corporation revised its formal method of amortizing the said costs of $3,422,870.23 against fixed price production contracts only and spread the amounts of such costs over all of its fixed

price and CPFF contracts for airplanes which Bell claims benefitted from the development work which it did. As a result, the amount of $3,422,870.23, adjusted to $3,374,465.00 by the elimination of certain overhead items was charged by Bell in 1943 against fixed price contracts and cost-plus-a-fixed-fee contracts as follows:

a. Against fixed price contracts.....	$1,087,645.05
b. Against CPFF contracts	2,286,819.95
Total	3,374,465.00

4. It also appears from letter to the District Supervisor, Eastern Procurement District, from the Contracting Officer at Bell Aircraft Corporation dated 5 June 1944, subject as above, that Bell Aircraft Corporation has already been reimbursed by the Government under its CPFF contracts for $1,299,855.92 of the amount of $2,286,819.95 noted above and that the General Accounting Office, by informal exceptions No. 777, 778, and 779, has raised the question of whether such amounts were properly reimbursed to Bell. It also appears from the letter of Bell Aircraft Corporation dated 5 January 1944 and referred to in paragraph 1 that Bell Aircraft Corporation has submitted, or is proposing to submit, claims for reimbursement under its CPFF contracts for the balance of the sum of $2,286,819.95.

5. By letter dated 30 October 1944, subject "Amortization of Development Expenses on CPFF Contracts" directed to the Bell Aircraft Corporation Contracting Officer, Bell states that it did not include in its quotations on fixed price production contracts referred to in paragraph 2 over which it originally amortized the development costs of $3,422,-870.23, the entire amount of such expenditures, but Bell does not indicate how much of such expenditures were, in fact, included in its fixed price quotations, and has failed to furnish any information which indicates that, notwithstanding the views of the Resident Auditor and the Contracting Officer stated in paragraph 2, it did not, in fact, recover through the fixed price production contracts referred to in paragraph 2 of the entire amount of such development expenses.

6. It appears that the said sum of $2,286,819.95 which Bell has charged on its books against CPFF contracts does not, in fact, represent costs of performing such CPFF contracts and that reimbursement for such costs under the said CPFF contracts would result in Bell's receiving double

payment from the Government therefor. It is therefore the opinion of this Headquarters that Bell is not entitled to reimbursement under its CPFF contracts for P-39 and P-63 airplanes for any portion of the said sum of $2,286,-819.95.

By Command of Lieutenant General KNUDSEN:

ORVAL R. COOK
Brig. General, U. S. A.
Chief, Procurement Division.

copy

Plaintiff's Exhibit 26

Capt. H. B. Davies
bmd; Contracting Officer

WAR DEPARTMENT
ARMY AIR FORCES
AIR TECHNICAL SERVICE COMMAND
EASTERN DISTRICT
OFFICE OF THE ARMY AIR FORCES REPRESENTATIVE

1 March 1945

Bell Aircraft Corporation, Niagara Frontier Division

SUBJECT: Findings of Fact and Decision of Contracting Officer

To: Bell Aircraft Corporation
2050 Elmwood Avenue
Buffalo 7, N. Y.

The finding of fact and decision of the Contracting Officer regarding amortization costs incurred on Experimental contracts as cited in letter from this office dated 10 January 1945 has been rescinded, and a new findings of fact and decision of the Contracting Officer is forwarded herewith.

/s/ H. B. DAVIES
H. B. DAVIES
Captain, Air Corps
Contracting Officer

Incl. (1)
Contracting Officer's ltr. dated 1 March 1945 cc: Resident Auditor

Capt. H. B. Davies
bmd; Contracting Officer

WAR DEPARTMENT
ARMY AIR FORCES
AIR TERMINAL SERVICE COMMAND
EASTERN DISTRICT
OFFICE OF THE ARMY AIR FORCES REPRESENTATIVE

1 March 1945

Bell Aircraft Corporation, Niagara Frontier Division

SUBJECT: Finding of Fact and Decision of Contracting Officer

To: Bell Aircraft Corporation
2050 Elmwood Avenue
Buffalo 7, N. Y.

1. As Contracting Officer of AAF under your Contract numbers W535 ac 40071, 20910, 29318, 40041, and DA W535 ac 156, Audit Voucher numbers as listed below, I find as fact:

Voucher No.	Contract No.	Amount
8449	W535 ac 40071	$ 29,102.96
8450	"	67,973.28
8445	"	11,774.48
8446	"	27,500.64
8447	"	29,880.52
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70-128*	W535 ac 20910	72,676.10
70-129*	"	113,052.07
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10606	DAW535 ac 156	13,888.85
10607	W535 ac 29318	177,652.86
10608	W535 ac 40041	44,413.35

* Terminated Contracts.

a. That during the years 1938, 1939, and 1940, Bell Aircraft Corporation expended a sum of $3,422,870.23 in connection with the development of experimental airplanes XP-39, XFM-1 and XFL-2, and that the prices of fixed price experimental contracts held by Bell with the Government were insufficient to cover any portion of such expenditures. It further appears that the said sum of $3,422,870.23 was full amortized by Bell Aircraft Corporation over certain fixed price production contracts between it and the United States Government and between it and the British Government during the years 1940, 1941, and 1942. It also appears that Bell Aircraft Corporation earned total aggregate net profits applicable to the paid fixed price production contracts of $17,590,201.57. The profits earned on the said fixed price production contracts, therefore, are more than enough to recover for Bell Aircraft Corporation the total amount of the expenditures of $3,422,870.23 referred to above, and were so treated on the books of Bell Aircraft Corporation.

b. That it appears that in 1943 as a result of conference with the Internal Revenue Department, Bell Aircraft Corporation revised its formal method of amortizing the said costs of $3,422,870.23 against fixed price production contracts only and spread the amount of such costs over all of its fixed price and CPFF contracts for airplanes which Bell claims benefitted from the development work which it did. As a result, the amount of $3,422,870.23, adjusted to $3,374,465.00 by the elimination of certain overhead items was charged by Bell in 1943 against fixed price contracts and cost-plus-a-fixed-fee contracts as follows:

(1) Against fixed price contracts.....	$1,087,645.05
(2) Against CPFF contracts.....	2,286,819.95
Totals	$3,374,465.00

c. That Bell Aircraft Corporation has already been reimbursed by the Government under its CPFF contracts for $1,299,855.92 of the amount of $2,286,819.95 noted above and that the General Accounting Office, by informal exceptions No. 777, 778, and 779, has raised the question of whether such amounts were properly reimbursed to Bell. It also appears that Bell Aircraft Corporation has submitted, or is proposing to submit, claims for reimbursement under its CPFF contracts for the balance of the sum of $2,286,819.95.

The amount of $1,299,855.92 was subsequently recouped by the Government by a deduction from audit vouchers.

d. By letter dated 30 October 1944, subject "Amortization of Development Expenses on CPFF Contracts" directed to the Bell Aircraft Corporation Contracting Officer, Bell states that it did not include in its quotations on fixed price production contracts referred to in paragraph 1a. over which it originally amortized the development costs of $3,422,-870.23, the entire amount of such expenditures, but Bell does not indicate how much of such expenditures were, in fact, included in its fixed price quotations, and has failed to furnish any information which indicates that, notwithtstanding the views of the Resident Auditor and the Contracting Officer, it did not, in fact, recover through the fixed price production contracts referred to in paragraph 1a., the entire amount of such development expenses.

e. It appears that the said sum of $2,286,819.95 which Bell has charged on its books against CPFF contracts does not, in fact represent costs of performing such CPFF contracts and that reimbursement for such costs under the said CPFF contracts would result in Bell's receiving double payment from the Government therefor.

2. It is, therefore, the decision of the Contracting Officer that Bell is not entitled to reimbursement under its CPFF contracts for P-39 and P-63 airplanes for any portion of the said sum of $2,286,819.95.

/s/ H. B. Davies
H. B. DAVIES
Captain, Air Corps
Contracting Officer.

End